

IN THE UNITED STATES DISTRICT COURT FOR THE  
EASTERN DISTRICT OF CALIFORNIA

FLAGSHIP WEST, LLC, et al.,	)	No. CV-F-02-5200 OWW/DLB
	)	
	)	MEMORANDUM DECISION AND
Plaintiffs,	)	ORDER GRANTING PLAINTIFFS'
	)	MOTION FOR INTERPRETATION OF
vs.	)	LEASE (Doc. 500) AND DENYING
	)	DEFENDANT'S MOTION TO STRIKE
	)	AND/OR FOR LEAVE TO FILE
	)	SUR-REPLY BRIEF (Doc. 508)
EXCEL REALTY PARTNERS, L.P.,	)	
et al.,	)	
	)	
	)	
Defendants.	)	
	)	
	)	

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This case is before the Court after remand by the Ninth Circuit Court of Appeal. The Ninth Circuit reversed the Court's granting of Flagship West, LLC's and Marvin and Kathleen Reiche's ("Flagship") election of rescission of its lease with Excel Realty Partners, L.P. ("Excel") after a jury found that Excel materially violated an "exclusive use" provision of the lease. The trial court ruling that judicial estoppel precluded Excel from asserting that § 4.5 of the lease bars rescission, was not

1 warranted and the limited remand was "so that the district court  
2 may determine in the first instance whether the contract, in its  
3 entirety, allows for rescission and whether California law would  
4 give effect to the lease's limitations on remedies in these  
5 circumstances." Specifically:

6       Excel ... appeals the district court's order  
7       granting Excel's tenant ..., rescission of  
8       its lease based on a determination that Excel  
9       materially violated an 'exclusive use'  
10      provision of that lease. The district court  
11      invoked judicial estoppel to prevent Excel  
12      from asserting that § 4.5 of the lease bars  
13      rescission. Because we find judicial  
14      estoppel was not warranted here, we remand  
15      for the district court to determine whether  
16      rescission is an available remedy under  
17      California law and the terms of the contract.

18      ...

19      First, Excel's litigation positions were not  
20      clearly inconsistent. There is no evidence  
21      that Excel ever conceded that rescission was  
22      available to Flagship. Although the Pretrial  
23      Order did not specifically cite § 4.5 of the  
24      lease or discuss all of the arguments that  
25      might be based on the section, it  
26      acknowledged that Excel contested Plaintiffs'  
27      entitlement to rescind, at least on both  
28      materiality and independent covenant grounds.  
29      Other related arguments that rescission was  
30      not available, including the contractual  
31      limitation on remedies argument at issue,  
32      were adequately embraced within the order

33      ....

34      Second, the district court never relied on a  
35      party's inconsistent statements ... Even  
36      though the district court may have been under  
37      the impression that rescission was being  
38      'actively litigated,' judicial estoppel is  
39      not appropriate unless the court made rulings  
40      in reliance on an admission by Excel that  
41      rescission was in fact available. No such  
42      reliance is possible here because, throughout  
43      the proceedings, Excel actively contested the

1 availability of rescission on a theory-by-  
2 theory basis. Excel had no legal obligation  
3 to pursue a general legal argument against  
4 rescission prior to its more narrow arguments  
5 because the argument regarding limitation of  
6 remedies available under the contract is not  
7 an affirmative defense under Fed. R. Civ. P.  
8 8(c) ....

9 Third, allowing Excel to raise its  
10 contractual remedies limitation argument  
11 after the jury had deliberated did not give  
12 Excel an unfair advantage or impose an unfair  
13 detriment on Flagship. Even if Excel had  
14 raised the argument at an earlier stage, the  
15 same factual issues would have been put to  
16 the jury to determine liability for damages.

17 Consequently, we vacate the district court's  
18 judgment awarding rescission damages to  
19 Flagship and remand so that the district  
20 court may determine in the first instance  
21 whether the contract, in its entirety, allows  
22 for rescission and whether California law  
23 would give effect to the lease's limitations  
24 on remedies in these circumstances. We do  
25 not reach either party's claims related to  
26 the calculation of rescission damages and  
express no opinion on those claims.

1 A supplemental scheduling conference was held. The  
2 Supplemental Scheduling Conference Order filed on August 14, 2009  
3 (Doc. 499), states: "Plaintiff shall not raise any new matter in  
4 the reply memorandum of law."

5 Flagship seeks interpretation of § 4.5 of the lease as not  
6 precluding rescission of the lease. Excel opposes Flagship's  
7 motion.

8 **A. BACKGROUND.**

9 Excel is the owner of the Briggsmore Plaza in Modesto. On  
10 July 16, 1998, Excel executed a 15 year ground lease ("Lease")  
11 with Flagship, whose only members are the Reiches, for a stand-

1 alone 10,000 square foot lot (the "Property") in the Briggsmore  
2 Plaza for the purpose of constructing and operating a buffet  
3 style restaurant under the Golden Corral franchise (the  
4 "Restaurant"). The Lease provides that Flagship has the  
5 "exclusive right to operate a self service buffet style family  
6 restaurant within the Shopping Center." (Lease § 6.3).

7 To construct the Restaurant, Flagship borrowed a 25 year, \$2  
8 million loan from The Money Store, which was secured by a deed of  
9 trust on Flagship's leasehold interest in the Property. The  
10 Reiches also executed written personal guarantees of the loan.  
11 The Restaurant opened on June 10, 1999, Approximately a year  
12 later, the Four Seasons, a buffet restaurant serving Chinese  
13 food, opened in the Briggsmore Plaza in a location directly  
14 across from the Restaurant. Based on an express lease provision,  
15 Flagship contended that the operation of the Four Seasons  
16 breached their exclusive right to run a buffet style restaurant  
17 in the shopping center and caused the Restaurant to become  
18 unprofitable, leading to its closure on April 1, 2001.

19 Flagship filed suit against Excel, alleging breach of  
20 contract, fraud, and negligent misrepresentation, seeking  
21 contract damages and rescission. In the Pretrial Order, Flagship  
22 requested a jury trial on all issues, while Excel relied on  
23 Flagship's jury demand instead of making one themselves. The  
24 case was tried to a jury. The trial commenced on November 12,  
25 2003 and verdicts were returned on December 3, 2003. The  
26 general verdict with interrogatories found in favor of Flagship

1 and awarded Flagship \$1,502,000.00 in contract damages.  
2 Specifically, the jury found that Flagship proved "by a  
3 preponderance of the evidence, that Defendant Excel Realty  
4 Partners, L.P., breached the lease by leasing space in the  
5 Briggsmore Plaza to Bi Wen Liu for the operation of the Four  
6 Seasons Buffet" and Excel's "breach of paragraph 6.3 of the lease  
7 agreement [was] material." (Doc. 280). Entry of judgment was  
8 deferred to allow Flagship to elect the remedy of rescission and  
9 any rescission damages or damages for breach of contract.

10 The "Order Re: Post Trial Election of Remedies; Defendants'  
11 Claimed Rescission Waiver Clause; Defendants' Claimed Damage  
12 Limitation Clause" filed on November 19, 2004 (November 19, 2004  
13 Memorandum Decision; Doc. 353), notes the parties' extensive  
14 post-trial briefing, addressing a number of issues. Rescission  
15 was elected and rescission damages awarded. A remedies lease  
16 provision barring rescission was found unenforceable.

17 B. FLAGSHIP'S MOTION FOR INTERPRETATION OF LEASE.

18 The primary issue before the Court is the proper  
19 interpretation of § 4.5 of the lease.<sup>1</sup> Section 4.5 provides:

20 4.5 Triple Net Lease. Tenant's Basic Rent  
21 and Additional Rent shall be absolutely net  
22 to Landlord, so that this Lease shall yield  
23 to Landlord the full amount of the  
installments of Basic Rent and Additional  
Rent throughout the Term, and shall be paid  
without assertion of any counterclaim, set

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24  
25 <sup>1</sup>At the hearing, Excel asserted that the Ninth Circuit's  
26 Memorandum remanding this case ruled that Section 4.5 constitutes  
a limitation on Flagship's right to rescind the lease. No such  
ruling can be inferred from the Ninth Circuit's Memorandum.

1 off, deduction or defense and without  
2 abatement, suspension, deferment, diminution,  
3 reduction or refund of any kind, except as  
4 expressly set forth herein. Under no  
5 circumstances whether now existing or  
6 hereafter arising, or whether beyond the  
7 present contemplation of the parties, shall  
8 Landlord be required to make any payment or  
9 refund of any kind whatsoever or be under any  
10 obligation or liability hereunder, except as  
11 expressly set forth herein. Except as  
12 otherwise expressly set forth in this Lease,  
13 this Lease shall continue in full force and  
14 effect, and the obligations of Tenant  
15 hereunder shall not be released, discharged  
16 or otherwise affected, by reason of any of  
17 the following: (a) any damage to or  
18 destruction of the Premises or any portion of  
19 either or any Taking of the Premises or any  
20 portion of either; (b) any restriction or  
21 prevention of or interference with any use of  
22 the Premises or any portion of either; or (c)  
23 any other occurrence whatsoever, whether  
24 similar or dissimilar to the foregoing, in  
25 each case, whether or not Tenant shall have  
26 notice or knowledge of any of the foregoing.  
The obligations of Tenant in this Lease shall  
be separate and independent covenants and  
agreements. Tenant hereby waives, to the  
fullest extent permitted by the applicable  
law, any and all rights now or hereafter  
conferred by statute or otherwise to quit,  
terminate or surrender this Lease or the  
Premises or any portion thereof, or to any  
abatement, suspension, deferment, diminution,  
reduction or refund of Basic Rent or  
Additional Rent, except as otherwise  
expressly set forth herein.

1. Independent and Separate Covenants.

Excel argues that rescission is barred because Flagship's obligations under the Lease are explicitly made separate and independent covenants by Section 4.5. Excel refers to the "Order Re: Post Trial Election of Remedies; Defendants' Claimed Rescission Waiver Clause; Defendants' Claimed Damages Limitation

1 Clause," filed on November 19, 2004, (November 19, 2004  
2 Memorandum Decision, Doc. 353), and specifically to 49:2-3 and  
3 51:8-15:

4 Plaintiffs were experienced and sophisticated  
5 restaurant operators.

6 ...

7 With respect to § 4.5, the Lease shows that  
8 the parties modified the provision, striking  
9 out the term 'or the Access Area' several  
10 times. These changes were ratified by  
initials 'MGR' (Marvin G. Reiche) in the  
margins. See Doc. 302, Ex. A, Lease, at 4.  
Plaintiffs cannot claim that § 4.5 escaped  
their notice.

11 Excel relies on these statements to assert that Section 4.5 was  
12 bargained for between sophisticated parties at arm's length.  
13 Therefore, Excel contends, Flagship cannot rescind or otherwise  
14 avoid their obligations under the Lease based on a violation of  
15 the exclusive use provisions in Section 6.3 of the Lease and  
16 asserts that Flagship's sole remedy is damages for Excel's breach  
17 of the exclusive use provisions.

18 Excel argues that it is unaware of any court that has  
19 allowed rescission for breach of an exclusive use clause in a  
20 lease that also provides that such clause is an independent  
21 covenant. Excel refers to the "Memorandum Decision and Order Re  
22 Post-Trial Election of Remedies" filed on September 30, 2005  
23 (September 30, 2005 Memorandum Decision, Doc. 362), at 14:13-17:

24 Breach of an independent covenant does not  
25 warrant rescission because, by definition,  
26 breach of an independent covenant is not  
material. By its very nature, an independent  
covenant does not run to the whole of the

1 consideration.

2 However, Excel's reference to the September 30, 2005

3 Memorandum Decision is incomplete:

4 Defendant asserts that materiality is not the  
5 central inquiry, and rather, the key inquiry  
6 is whether the covenant breached is  
7 independent. It is true that some courts  
8 approach the question of rescission based at  
9 least in part on an analysis of whether the  
10 provision breached was a dependent or  
11 independent covenant. See, e.g., *Medico-*  
12 *Dental*, 21 Cal.2d at 418-19; *Mills*, 56  
13 Cal.App. at 776. This follows because the  
14 factors that determine whether a covenant is  
15 independent, overlap with the factors that in  
16 determine [sic] whether a breach was  
17 material. *Medico-Dental*, 21 Cal.2d at 433.  
18 Breach of an independent covenant does not  
19 warrant rescission because, by definition,  
20 breach of an independent covenant is not  
21 material. By its very nature, an independent  
22 covenant does not run to the whole of the  
23 consideration. However, what Defendant has  
24 not provided is citation to any authority  
25 holding that exclusive use provisions, such  
26 as the one at issue here, are independent  
covenants as a matter of law. In fact, the  
courts in the two cases upon which Defendant  
relies, *Kulawitz* and *Medico-Dental*, found  
that the exclusive use covenants at issue  
there were dependent, based on an analysis of  
the factors and the factual record.

19 In this case, the jury has already made a  
20 finding that the breach was material. It is  
21 not necessary for the court to now decide, as  
22 a matter of law, that the covenant at issue  
23 was independent. The provision was integral  
24 to the Lease, which would not have been  
25 entered into without it. The answer to the  
26 mixed question of law and fact as to  
independence of the provision is irrelevant  
to the question whether the Plaintiff is  
entitled to elect rescission. The jury's  
finding of materiality provides sufficient  
grounds for rescission, according to well-  
established California law.

1 (September 30, 2005 Memorandum Decision at 14:4-15:5).

2 Excel argues that *Kulawitz v. The Pacific Woodenware and*  
3 *Paper Co.*, 25 Cal.2d 664 (1944) and *Medico-Dental Bldg. Co. v.*  
4 *Converse*, 21 Cal.2d 411 (1942), "stand for a proposition that has  
5 no bearing on this case." Excel contends that "[a]bsent an  
6 express statement in the lease that covenants are independent, a  
7 court may determine that the covenants involved are conditions  
8 precedent so that a breach may justify rescission if it goes to  
9 the heart of the matter." Excel contends that such analysis is  
10 only necessary where there is no explicit agreement by the  
11 parties and is unwarranted here "because the Ground Lease  
12 specifies that Plaintiffs' obligations are independent of Excel's  
13 compliance with its obligations." Excel asserts that the jury  
14 verdict of "material breach" during the breach of contract phase  
15 of the trial "does not overrule the clear tenant of California  
16 law that where the parties to a contract agree that the terms  
17 thereof are independent covenants, a breach will not justify  
18 rescission."

19 Excel's contention that Section 4.5 makes *Excel's* obligation  
20 to honor the exclusive use provisions of the Lease an independent  
21 covenant ignores the express wording of Section 4.5: Section 4.5  
22 deals with a tenant's obligation to pay rent and provides that  
23 "[t]he obligations of Tenant in this Lease shall be separate and  
24 independent covenants and agreements." Section 4.5 does not  
25 provide that any of the landlord's obligations under the Lease  
26 are independent covenants. As Flagship asserts: "Defendants cite

1 no authority in support of their position, and without  
2 explanation assert that because the Lease states Tenant's  
3 obligations are 'independent covenants,' that the Landlord's  
4 obligations are independent as well." Flagship cites *Medico-*  
5 *Dental, supra*, 21 Cal.2d at 419, in turn citing 32 Am.Jur. § 144,  
6 that "'covenants and stipulations on the part of the lessor and  
7 lessee are to be construed to be dependent upon each other or  
8 independent of each other, according to the intention of the  
9 parties and the good sense of the case, and technical words  
10 should give way to such intention.'" Flagship contends:

11           Excel's interpretation patently ignores the  
12           circumstances of this case, the undisputed  
13           evidence that the exclusive use provision was  
14           central to the Lease, and the jury's finding  
15           of materiality, in arguing that a clause  
16           providing that the *Tenant's obligations* are  
17           independent also means the Landlord's  
18           obligations are independent. In making this  
19           argument, Defendants are asking the court to  
20           read the word 'Landlord' into the provision,  
21           without any supporting evidence that that is  
22           what was intended by the parties.

23 Contrary to Excel's contention, Flagship argues, there is no  
24 "express statement" in the Lease making Excel's obligation to  
25 honor the exclusive use clause an independent covenant. Flagship  
26 argues that Excel's interpretation of Section 4.5 allows Excel to  
treat every obligation it had under the Lease as optional,  
precluding Flagship from rescinding the Lease under any  
circumstances:

Excel presents no support for its position  
that any party can be required to stay in a  
contract which the other party has materially  
failed to perform. Without the consideration

1 Flagship expressly bargained for, the Lease  
2 failed. The language making Flagship's  
3 covenants to pay rent 'independent' did not  
4 in way [sic] alter Defendants' obligation to  
honor the exclusive use provision, and does  
not make that provision any less central to  
the parties' bargain.

5 Excel argues that Section 6.3 of the Lease provides a remedy  
6 in damages for breach of the exclusive use clause. Section 6.3  
7 provides:

8 6.3 Exclusive Use Rights. Subject to the  
9 conditions and restrictions set forth herein,  
10 Tenant shall have the exclusive right to  
11 operate a self service buffet style  
restaurant within the Shopping Center, except  
that such exclusive right:

12 ...

13 (h) Shall not result in Landlord being liable  
14 to Tenant for monetary damages for any other  
15 tenants' or occupants' violation of such  
16 exclusive use privilege of Tenant unless,  
with respect to future tenants or occupants  
..., Landlord has failed to restrict such  
tenant or occupant from violating Tenant's  
exclusive use privilege granted in this Lease

17 ....

18 Flagship responds that Section 6.3(h) does not restrict the  
19 tenant from rescinding the Lease if Excel failed to prevent  
20 future tenants from violating Flagship's exclusive use privilege.  
21 Flagship notes that Excel cites no authority that a damages  
22 provision limits the ability of a party to a contract from  
23 rescinding the contract because of a material breach. Flagship  
24 cites California Civil Code § 1692, which provides that "[a]  
25 claim for damages is not inconsistent with a claim for relief  
26 based upon rescission." Flagship refers to the November 19, 2004

1 Memorandum Decision that "[i]n the event rescission is elected, §  
2 22.25 cannot be enforced as rescission avoids enforceability of  
3 clauses of the Lease, including damage limitations."

4       Flagship's contentions are well-taken. Section 4.5 by its  
5 terms provides that the tenant's obligation to pay rent under the  
6 lease is an independent covenant. Section 4.5 does not refer in  
7 any way to the landlord's obligations to the tenant under the  
8 lease. To the contrary, Section 6.3 imposes an express duty on  
9 Excel to restrict any other tenant from violating Flagship's  
10 exclusive use privilege. This imposed an express obligation on  
11 Excel which was integral to the lease and represented a dependent  
12 covenant. The jury specifically found that Excel's breach of the  
13 exclusive use provision in Section 6.3 of the lease was material.  
14 Excel's contention that the jury's verdict on this issue is  
15 irrelevant to the determination that Section 4.5 makes Excel's  
16 obligations under the lease independent covenants not only  
17 ignores the verdict, which is now final, but ignores the plain  
18 language of the lease, expressly imposing the duty on Excel to  
19 protect the exclusive use right.

20               2. Waiver of Section 4.5.

21       Flagship argues that Excel waived the defense of Section 4.5  
22 by not presenting the issue to the jury and that Excel has the  
23 burden of establishing that Section 4.5 operated as a waiver of  
24 the right to rescind by clear and convincing evidence.

25       Excel rejoins that the Ninth Circuit "specifically ruled  
26 that § 4.5 was not an affirmative defense (affirming this Court's

1 earlier ruling)." The Ninth Circuit, in reversing the finding  
2 of judicial estoppel, ruled that there was no evidence that the  
3 Court relied on any inconsistent statement by Excel: "Excel had  
4 no legal obligation to pursue a general legal argument against  
5 rescission prior to its more narrow arguments because the  
6 argument regarding limitation of remedies available under the  
7 contract is not an affirmative defense under Fed. R. Civ. P.  
8 8(c)." 8

9 In the November 19, 2004 Memorandum Decision, 40:3-41:26,  
10 the Court addressed Flagship's contention that Sections 4.5 and  
11 22.25 were affirmative defenses that were waived by Excel by  
12 failure to raise them in the Answer. The discussion in the  
13 November 19, 2004 Memorandum Decision is limited to contractual  
14 limitation of damages clauses:

15 With respect to contractual limitations on  
16 damages in a contract dispute, the defense is  
17 contained in the cause of action itself.  
18 Both sides had full access to the Lease (38  
pages long) and are presumed to have examined  
it carefully. There is no danger of unfair  
surprise by assertion of this defense.

19 This discussion is limited to Section 22.25 of the Lease; it does  
20 not address Section 4.5 as an affirmative defense. Excel relies  
21 on the Ninth Circuit's ruling to assert that it had no burden of  
22 proof "with respect to this issue or other purported 'waiver'  
23 issues proffered by Plaintiffs." Excel contends that the burden  
24 is on Flagship to prove their entitlement to rescission.

25 Flagship's waiver argument is premised on the contention  
26 that application of Section 4.5 to bar rescission is Excel's

1 affirmative defense. The Ninth Circuit's ruling resolves  
2 Flagship's position.<sup>2</sup>

3 Excel previously argued that "[i]n § 4.5 Plaintiffs have  
4 expressly waived the right to 'quit, terminate or surrender' the  
5 Lease 'except as otherwise expressly set forth herein' and there  
6 is not 'otherwise' in the Lease" and that Section 4.5 precludes  
7 rescission "' ... by reason of ... any restriction or prevention  
8 of or interference with any use of the Premises."

9 Flagship argues that Section 4.5's plain language reveals  
10 that it does not constitute a waiver of rescission. Flagship  
11 notes that the term "rescission" does not appear in Section 4.5  
12 and cites California case law in support of its contention that  
13 the terms "quit," "terminate," or "surrender" are not synonyms  
14 for rescission and have distinct unrelated meanings within the  
15 context of the Lease.

16 Flagship invokes principals of contract interpretation.

17 In California, "the intention of the parties as expressed in  
18 the contract is the source of contractual rights and duties. A  
19 court must ascertain and give effect to this intention by  
20 determining what the parties meant by the words they used."

21 *Pacific Gas and Electric Co. v. G.W. Thomas Drayage & Rigging*  
22 *Co., Inc.*, 69 Cal.2d 33, 38 (1968). "The precise meaning of any  
23

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24 <sup>2</sup>The Ninth Circuit's ruling makes unnecessary any discussion  
25 of Flagship's contention that Excel waived the right to contest  
26 rescission by failing to present the issue to the jury and  
establishing that Section 4.5 operated as a waiver of rescission by  
clear and convincing evidence.

1 contract ..., depends upon the parties' expressed intent, using  
2 an objective standard." As explained in *Waller v. Truck Ins.*  
3 *Exchange, Inc.*, 11 Cal.4th 1, 18-19 (1995):

4       The fundamental rules of contract  
5       interpretation are based on the premise that  
6       the interpretation of a contract must give  
7       effect to the 'mutual intention' of the  
8       parties. 'Under statutory rules of contract  
9       interpretation, the mutual intention of the  
10      parties at the time the contract is formed  
11      governs interpretation. [Civ.Code, § 1636.]  
12      Such intent is to be inferred, if possible,  
13      solely from the written provisions of the  
14      contract. [*Id.*, § 1639.] The 'clear and  
15      explicit' meaning of these provisions,  
16      interpreted in their 'ordinary and popular  
17      sense,' unless 'used by the parties in a  
18      technical sense or a special meaning is given  
19      to them by usage' (*id.*, § 1644), controls  
20      judicial interpretation ... A [contract]  
21      provision will be considered ambiguous when  
22      it is capable of two or more constructions,  
23      both of which are reasonable ... But language  
24      in a contract must be interpreted as a whole,  
25      and in the circumstances of the case, and  
26      cannot be found to be ambiguous in the  
27      abstract ... Courts will not strain to create  
28      an ambiguity where none exists.

29 "Interpretation of a contract 'must be fair and reasonable, not  
30 leading to absurd conclusions'" and a court "'must avoid an  
31 interpretation which will make a contract extraordinary, harsh,  
32 unjust, of inequitable.'" *ASP Properties Group v. Fard, Inc.*,  
33 133 Cal.App.4th 1257, 1269 (2005):

34       Section 1643 provides: 'A contract must  
35       receive such an interpretation as will make  
36       it lawful, operative, definite, reasonable,  
37       and capable of being carried into effect, if  
38       it can be done without violating the  
39       intention of the parties.' In the event  
40       other rules of interpretation do not resolve  
41       an apparent ambiguity or uncertainty, 'the  
42       language of a contract should be interpreted

1           most strongly against the party who cause the  
2           uncertainty to exist.' (§ 1654).

3       *Id.*

4           Flagship argues that, applying these rules of contract  
5       interpretation, Section 4.5 cannot be reasonably interpreted as a  
6       waiver of its right to rescind or as precluding rescission in any  
7       way. Flagship contends that Excel waived the right to argue that  
8       extrinsic evidence should be considered in interpreting the Lease  
9       because it did not present extrinsic evidence at trial concerning  
10      the meaning of the Lease or request findings of fact by the jury  
11      through special interrogatories.

12          Flagship contends that the plain language of Section 4.5  
13      does not constitute a waiver of its right to rescind.<sup>3</sup>

14          Flagship asserts the word "terminate" is not synonymous with  
15      "rescission." Flagship cites *Welles v. Turner Entertainment Co.*,  
16      503 F.3d 728 (9<sup>th</sup> Cir.2007). In *Welles*, the daughter of Orson  
17      Welles sought a declaratory judgment that she owned the copyright  
18      and home video rights to "Citizen Kane," an accounting of  
19      royalties, and for alleged breach of contract and unfair business  
20      practices. In pertinent part, the Ninth Circuit ruled:

21               As noted above, the Exit Agreement stated  
22               that it was 'the mutual desire of the parties  
23               to terminate and cancel' their prior  
24               agreements. Beatrice Welles argues that this  
25               language rescinded the parties' prior  
26               agreements and thus returned any right Orson

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25      <sup>3</sup>Flagship requests the Court take judicial notice of various  
26      definitions of "rescission," or "rescind," "quit," "terminate" and  
26      "surrender" set forth in various recognized dictionaries. See Doc.  
26      501.

1 Welles and Mercury had in the *Citizen Kane*  
2 motion picture to them. However, under  
3 California law, it seems that 'terminate' and  
'cancel' mean something different from  
'rescind':

4 The words "terminate," "revoke,"  
5 and "cancel," ... all have the same  
6 meaning, namely, the abrogation of  
7 so much of the contract as might  
8 remain executory at the time notice  
9 is given, and must be sharply  
distinguished from the word  
"rescind," ... which conveys a  
retroactive effect, meaning to  
restore the parties to their former  
position.

10 *Grant v. Aerodraulics Co.*, 91 Cal.App.2d 68  
11 ... (1949). Thus, under California law, the  
12 Exit Agreement prospectively terminated and  
13 cancelled Orson Welles's right to royalties,  
14 but did not retroactively rescind RKO's  
copyright in the *Citizen Kane* motion picture  
unless RKO's copyright remained executory at  
the time of the Exit Agreement.

15 503 F.3d at 738. See also *Sanborn v. Ballanfonte*, 98 Cal.App.  
16 482, 488 (1929).

17 Flagship argues that the Lease uses the word "terminate"  
18 consistently with its definition under California law as  
19 explained in *Sanborn* and *Grant*. Flagship refers to Section 18.2  
20 of the Lease, captioned "Remedies:"

21 (a) If an Event of Default shall occur, then,  
22 in addition to any other remedies available  
23 to Landlord at law or in equity, Landlord  
shall have the right to immediately terminate  
this Lease, and to recover from the Tenant  
the following:

24 (1) the worth at the time of award  
25 of the unpaid Basic Rent, Additional Rent,  
26 and other sums owing by Tenant under this  
Lease (collectively 'Rent') which had been  
earned at the time of termination;

1 (2) the worth at the time of award  
2 of the amount by which the Unpaid Rent would  
3 have been earned after termination until the  
4 time of award exceeds the amount of such  
5 rental loss that Tenant proves could have  
6 been reasonably avoided.

7 ....

8 Flagship also refers to Section 6.4 of the Lease, captioned  
9 "Cessation of Business:"

10 If, after the Commencement Date, Tenant  
11 ceases business from the Premises for a  
12 period of one hundred eighty (180) days in  
13 any sixty (60) month period, Landlord shall  
14 have the option, by written notice to Tenant,  
15 to terminate this Lease as of the date set  
16 forth in such notice, which date shall not be  
17 earlier than thirty (30) days after the date  
18 of such notice. In the event Landlord elects  
19 to terminate this Lease as described above,  
20 this Lease shall be null and void and of no  
21 further force or effect on the date set forth  
22 for such termination, except that accrued but  
23 unpaid or unperformed obligations shall  
24 continue in effect; provided, however, that  
25 Landlord shall pay to Tenant on the effective  
26 termination date the unamortized cost  
the improvements ....

Flagship refers to Section 15 of the Lease, captioned "Eminent  
Domain," and specifically Sections 15.1(a) ("In the event of a  
Total Taking of the Premises, the Lease shall terminate as of the  
date of the Taking ...") and 15.2(a) ("If a Partial Taking  
results [in specified loss of parking or premises], then Tenant  
may, at Tenant's option, terminate this Lease in its entirety as  
of the date of the Taking, in which case Landlord and Tenant  
shall be released from all further obligations and liability  
under the Lease ..."). Flagship argues that interpretation of

1 the word "terminate" in Section 4.5 to have a different meaning  
2 from these Lease provisions violates a basic premise of contract  
3 interpretation law. See *E.M.M.I. Inc. v. Zurich American Ins.*  
4 *Co.*, 32 Cal.4th 465, 475 (2004):

5       Accepting Zurich's interpretation would  
6       require that we give different meanings to  
7       the same term used in the same policy  
8       paragraph. This would run afoul of the rule  
9       of contract interpretation that the same word  
10      used in an instrument is generally given the  
11      same meaning unless the policy indicates  
12      otherwise.

13       Flagship also contends that the term "surrender" is not  
14      synonymous with "rescission." Flagship cites *Scott v. Mullins*,  
15      211 Cal.App.2d 51, 55 (1962):

16       A surrender is a yielding up of an estate for  
17      life or years to the reversioner or  
18      remainderman. A surrender yields the estate  
19      as distinguished from the possession and can  
20      be accomplished by express consent of the  
21      parties in writing, or by operation of law  
22      when the parties do something which implies  
23      they have consented.

24       "In landlord-tenant law, surrender exists when the tenant  
25      voluntarily gives up possession of the premises prior to the full  
26      term of the lease and the landlord accepts possession with intent  
27      that the lease be terminated." *Black's Law Dictionary* at 1444  
28      (6<sup>th</sup> ed.1990).

29       Flagship also contends that the term "surrender" in the  
30      Lease is used consistently with the definition under California  
31      law. Flagship refers to Section 22.5 of the Lease, captioned  
32      "Removal of Trade Fixtures During Term; Delivery at End of Term:"

33       At any time during the Term of the Lease,

1           Tenant may remove from the Premises any trade  
2           fixtures, machinery or equipment belonging to  
3           Tenant or third parties, provided Tenant  
4           shall repair any damage to the Premises  
5           caused by such removal. Upon expiration or  
6           earlier termination of this Lease, Tenant  
7           shall surrender the Premises ... and all  
8           portions thereof, to Landlord in good order,  
9           condition and repair ....

10          Section 22.11 of the Lease, captioned "Modification; Acceptance  
11          of Surrender," provides:

12                 No modification, amendment, termination or  
13                 surrender of this Lease or surrender of the  
14                 Premises or any portion thereof or of any  
15                 interest therein by Tenant shall be valid or  
16                 effective unless agreed to and accepted in a  
17                 writing signed by Landlord, and no act by any  
18                 representative or agent of Landlord, other  
19                 than such a written agreement and acceptance  
20                 by Landlord, shall constitute an agreement  
21                 thereto or acceptance thereof.

22          Flagship argues that the term "quit" is not synonymous with  
23          rescission. Flagship cites *Grand Central Public Market v.*  
24          *Kojima*, 11 Cal.App.2d 712, 717 (1936). In *Kojima*, the landlord  
25          sent two three day notices to its tenant to pay rent or quit.  
26          The notices were ignored by the tenant and not acted upon by the  
27          landlord and expired by their terms. The landlord then sent the  
28          tenant a letter stating that if back rent was not paid, the  
29          landlord would commence suit to remove the tenant from the  
30          premises. The landlord sued the tenant, who quit the premises  
31          the day after the suit was filed. The tenant argued that it was  
32          not liable for the rent for the month of January, because the  
33          lease terminated when he quit the premises. The Court of Appeal  
34          ruled:

1           The lease is terminated only if the notice is  
2           acted upon by one of the parties. If the  
3           lessor had brought an unlawful detainer suit  
4           based upon the notices to quit, as they were  
5           framed in this case, then the court trying  
6           such unlawful detainer action would, upon a  
7           proper showing, have the undoubted right to  
8           decree a forfeiture of the lease ... Or, if  
9           the lessee within the three-day period  
10          specified in the notices had quit the  
11          premises, the respective lease would have  
12          been forfeited by agreement of the parties,  
13          since the lessee would be in the position of  
14          accepting lessor's offer to terminate the  
15          same ... Neither of these methods was  
16          followed or taken advantage of by either of  
17          the parties. When a lessor, as did the  
18          lessor in this case, claims or collects rent  
19          in an action, or otherwise, as the result of  
20          a legal proceeding, or otherwise, he waives  
21          his existing right to effect a termination.

22       Flagship relies on this to argue that the physical act of  
23       quitting the premises in and of itself does not effect  
24       termination of a lease: "Similarly, prohibition on 'quitting' the  
25       premises or a waiver of one's right to 'quit' the premises in no  
26       way could be interpreted as a waiver of one's right to rescind  
27       the lease."

28           Excel responds that Flagship's "hyper-technical argument"  
29       based on the definitions of "terminate," "surrender" or "quit"  
30       does not address the meaning of Section 4.5 as a whole. Excel  
31       asserts that Flagship's "convoluted argument boils down to the  
32       contention that because § 4.5 does not contain the word  
33       'rescission,' rescission is not barred." Excel refers to the  
34       November 19, 2004 Memorandum Decision discussing the effect of  
35       rescission on contractual clauses at 41:18-44:25:

36           With respect to § 4.5, Defendants cite a

1 California Court of Appeals opinion which  
2 states an alternate holding for denying  
rescission:

3 In plaintiffs' closing brief, not  
4 before, our attention was drawn to  
5 a provision contained in the  
6 subcontract agreement of plaintiff  
7 ...: 'Subcontractor, in the event  
8 of any dispute or controversy with  
9 Contractor or any other  
10 subcontractor over any matter  
11 whatsoever, shall not cause any  
12 delay or cessation in or of  
13 Subcontractor's work or the work of  
14 any other subcontractor or of the  
15 Contractor but shall proceed under  
16 this Subcontract Agreement with the  
17 performance of the work required  
18 thereby.'

19 The quoted clause bound  
20 [Subcontractor] to finish its work  
21 regardless of any dispute with  
22 [Contractor]. In effect, the  
23 clause was an advance waiver of any  
24 right to rescind after partial  
25 performance. The net result of the  
26 clause was to make a breach of  
contract action the subcontractor's  
exclusive remedy. (Nelson v.  
Spence, 182 Cal.App.2d 493, 497  
...; 5A Corbin on Contracts, §  
1227; 17A C.J.S., Contracts, §  
422[1], p. 521, fn. 62.). Having  
committed itself to complete  
performance, [Subcontractor] was  
confined to the remedy and to make  
the scale of damages available to  
one who has completed his contract  
notwithstanding a breach by the  
other party - suit on the contract  
and recovery by the scale of  
damages which the law applies in  
such suits.

24 *B.C. Richter Contracting Co. v. Continental*  
25 *Casualty Co.*, 230 Cal.App.2d 491, 500-501  
26 (Cal.Ct.App. 1964). The provision waiving  
rescission was applicable even though it was  
first noticed on appeal after the completion

1 of a bench trial. The cited provision does  
 2 not mention the term 'rescission' and was  
 3 found to be a valid waiver of that remedy.  
 4 Its language is comparable to § 4.5.

5 The opinion upheld a valid anti-rescission  
 6 clause, although rescission would void the  
 7 effect of all other contractual clauses. The  
 8 cases Plaintiff cite to the contrary do not  
 9 negate the ability to waive the remedy of  
 10 rescission. See e.g. *Guerini Stone Co. v.*  
 11 *P.J. Carlin Constr. Co.*, 248 U.S. 334, 341  
 12 (1919) (subcontractor properly terminated  
 13 contract when project was indefinitely  
 14 delayed; 'the 11<sup>th</sup> paragraph of the sub-  
 15 contract, providing: "The general contractors  
 16 will provide all labor and materials not  
 17 included in this contract in such manner as  
 18 not to delay the material progress of the  
 19 work, and in the event of failure so to do,  
 20 thereby causing loss to the sub-contractor,  
 21 agree that they will reimburse the sub-  
 22 contractor for such loss," as applied to the  
 23 facts of the case, imported an agreement by  
 24 defendant to furnish the foundation in such  
 25 manner that plaintiff might build upon it  
 26 without delay, and was inconsistent with an  
 implication that the parties intended that  
 delays attributable to the action of the  
 owner should leave plaintiff remediless');  
*Gally v. Wynne*, 96 Cal.App. 145, 147  
 (Cal.Ct.App. 1929) (the contract provision in  
 question stated 'In the event I violate any  
 part of this agreement I agree to deduct \$500  
 from the purchase price of \$3500,' which is  
 not an anti-rescission clause); *Dyer Bros.*  
*Golden West Iron Works v. Central Iron Works*,  
 72 Cal.App. 202, 207 (Cal.Ct.App.1925) (both  
 parties breached the contract, voiding the  
 liquidated damages clause).

27 The *B.C. Richter* holding cited by Defendants  
 28 has been affirmed by more recent opinions.  
 29 See *Fosson v. Palace (Waterland), Ltd.*, 78  
 30 F.3d 1448, 1455 (9<sup>th</sup> Cir.1996) ('Fosson  
 31 admitted that he read and understood the  
 32 Synch License provision in which he waived  
 33 his right to rescind or terminate the  
 34 agreement .... Thus, Fosson has no right to  
 35 rescind as a matter of law by virtue of his  
 36 waiver.');

*Michel & Pfeffer v. Oceanside*

1           *Properties, Inc.*, (1976) 61 Cal.App.3d 433,  
2           442 (specifically distinguishing *Guerini* as  
3           not mandating the performance of the  
4           contract, hence no waiver of rescission).  
5           These cases affirm the general enforceability  
6           of an anti-rescission clause.

7           Excel asserts that Flagship cites no authority that requires the  
8           explicit use of the term "rescission" in order to bar rescission  
9           as a remedy. Excel contends the result reached in *B.C. Richter*  
10          should apply here, "because all facets of rescission are barred  
11          by § 4.5."

12          Flagship replies that Excel's reliance on *B.C. Richter* and  
13          the November 19, 2004 Memorandum Decision is misplaced. Flagship  
14          contends that Excel argued to the Ninth Circuit on appeal that  
15          the Court correctly determined that Section 4.5 barred rescission  
16          based on *B.C. Richter* and the other cases cited in the November  
17          19, 2004 Memorandum Decision. Excel contended on appeal that,  
18          had it not been for the finding of judicial estoppel, Section 4.5  
19          would have prevented rescission. The Ninth Circuit remanded "so  
20          that the district court may determine in the first instance  
21          whether the contract, in its entirety, allows for rescission and  
22          whether California law would give effect to the lease's  
23          limitations on remedies in this circumstances." Implicit in  
24          these instructions, Flagship contends, is a rejection of Excel's  
25          position that *B.C. Richter*, *Fosson*, and *Michel & Pfeffer* require,  
26          as a matter of law, that Section 4.5 be interpreted as a waiver  
27          of rescission."

28          Flagship argues that the circumstances of the cases on which

1 Excel relies are different from the facts of this case:

2 "[n]either *B.C. Richter, Fosson*, nor *Michel & Pfeffer* involved a  
3 landlord's undisputed material breach of a 25 year ground lease a  
4 year after the lease commenced."

5 In *Fosson* a composer brought a copyright infringement action  
6 against movie producers and a financing company. The District  
7 Court granted summary judgment for defendants. On appeal, the  
8 Ninth Circuit addressed the circumstances under which a  
9 subsequent breach of an express license, which may constitute  
10 grounds for rescission, can give rise to a suit for infringement  
11 by the licensor. Flagship argues that *Fosson* is distinguishable  
12 because there, the remedies limitation clause specifically  
13 provided that the licensor "shall not have any right to terminate  
14 or rescind this Agreement" and because *Fosson* admitted that he  
15 read and understood the agreement. Flagship notes that Section  
16 4.5 does not mention the term "rescission" and contends that  
17 there is no testimony in this action regarding any party's  
18 understanding of Section 4.5.

19 In *Michel & Pfeffer*, a subcontractor on a building project  
20 brought an action against the contractor, the contractor's  
21 surety, and the property owners for payment on a bond,  
22 foreclosure of a mechanic's lien, and a common count based on  
23 work performed. Flagship contends: "These circumstances alone  
24 point to why remedies' limitation clauses in construction  
25 contracts may be generally enforced, as the subcontractor has  
26 both the security of the bond and mechanics lien statutes to

1 secure payment for his work done." Flagship asserts that also at  
2 issue in *Michel & Pfeffer* was a delay of the subcontractor's work  
3 caused by the contractor. The contract provided that an  
4 extension of time for delays "shall be the sole remedy of  
5 Subcontractor." Flagship argues that *Michel & Pfeffer* is  
6 distinguishable because Section 4.5 does not provide for any sole  
7 remedy for the landlord's breach and does not reference or  
8 otherwise pertain to the landlord's obligation to honor  
9 Flagship's exclusive use rights.

10 *B.C. Richter* involved actions by subcontractors on the prime  
11 contractor's surety bond for quantum meruit recovery to be  
12 measured by the reasonable value of unpaid labor and materials.  
13 The trial court ruled that the subcontractors' recovery was  
14 limited to the unpaid remainder of the contract price. On  
15 appeal, the subcontractors argued that the breaches and defaults  
16 by the contractor entitled them to forego the contract price as  
17 the strict measure of liability, permitting recovery by the more  
18 generous scale of quantum meruit or reasonable value. The Court  
19 of Appeal ruled:

20 Plaintiffs' thesis rests upon misconceptions  
21 of contract law and misuse of the phrase  
22 'quantum meruit.' The general rule in  
23 California is "'... one who has been injured  
24 by a breach of contract has an election to  
25 pursue any of three remedies, to wit: 'He may  
26 treat the contract as rescinded and may  
recover upon a quantum meruit so far as he  
has performed; or he may keep the contract  
alive, for the benefit of both parties, being  
at all times ready and able to perform; or,  
third, he may treat the repudiation as  
putting an end to the contract for all

1 purposes of performance, and sue for the  
2 profits he would have realized if he had not  
3 been prevented from performing.'"" ... When,  
4 after partial performance, the innocent party  
5 elects to disaffirm or rescind, there is no  
6 longer any contract which conclusively fixes  
7 a limit upon his recovery; hence, it is said,  
8 he may sue upon a quantum meruit as if the  
9 special contract had never been made and may  
10 recover the reasonable value of the services  
11 performed, even though recovery exceeds the  
12 contract price ....

13 If the innocent party chooses to rescind, he  
14 must do so promptly upon discovery of the  
15 breach ... He may not wait to see whether the  
16 contract turns out to be profitable or  
17 unprofitable, good or bad ....

18 Where his performance is not prevented, the  
19 injured party may elect instead to affirm the  
20 contract and complete performance. If such  
21 is his election, his exclusive remedy is an  
22 action for damages ... Affirmation of the  
23 contract, on the one hand, and rescission and  
24 restitution on the other, are alternative  
25 remedies. Election to pursue one is a bar to  
26 invoking the other ....

1 In plaintiffs' closing brief, not before, our  
2 attention was drawn to a provision contained  
3 in the subcontract agreement of plaintiff  
4 B.C. Richter Contracting Company, but not in  
5 the subcontract of R. & E. Materials Company:  
6 'Subcontractor, in the event of any dispute  
7 or controversy with Contractor or any other  
8 subcontractor over any matter whatsoever,  
9 shall not cause any delay or cessation in or  
10 of Subcontractor's work or the work of any  
11 other subcontractor or the Contractor but  
12 shall proceed under this Subcontract  
13 Agreement with the performance of the work  
14 required thereby.'

15 The quoted clause bound Richter to finish its  
16 work regardless of any dispute with Hayes-Cal  
17 Builders. In effect, the clause was an  
18 advance waiver of any right to rescind after  
19 partial performance ... Having committed  
20 itself to complete performance, Richter  
21 Contracting was confined to the remedy and to

1 the scale of damages available to one who has  
2 completed his contract notwithstanding a  
3 breach by the other party - suit on the  
contract and recovery by the scale of damages  
which the law applies in such suits ....

4 On the assumption that Hayes-Cal was guilty  
5 of hindrances and defaults amounting to a  
6 breach of contract conditions, the other  
7 plaintiff, R. & E. Materials Company, had an  
8 election to rescind promptly or to stand on  
its contract and continue performance.  
9 Choice of the first alternative would have  
permitted R. & E. Materials to sue in quantum  
10 meruit for the reasonable value of partial  
11 performance, less any sums paid. The joint  
12 venture did not choose that alternative. The  
13 trial court correctly concluded that it lost  
all right to rescind by failing to do so  
14 promptly after the cessation of progress  
payments. It is equally accurate to say that  
15 it elected not to repudiate the subcontract,  
16 but to affirm it and continue performance.  
17 Having chosen the second alternative, it was  
18 then barred from repudiation and pursuit of  
reasonable value.

19 Thus, when both plaintiffs argue on appeal  
20 for 'quantum meruit' unlimited by the  
contract price, they speak in terms not  
21 available to them. Their remedy was that  
22 imposed upon them, in the one case, by the  
contract and in the other by their election  
23 to perform: to sue for the unpaid balance of  
the contract price plus extra costs caused by  
24 hindrances and delay.

25 230 Cal.App.2d at 499-501.

26 Flagship asserts that the court in *B.C. Richter* did not find  
that the remedies provision barred rescission outright. *B.C.*  
*Richter* ruled that the "clause bound Richter to finish its work  
regardless of any dispute with Hayes-Cal Builders" and that  
"clause was an advance waiver of any right to rescind after  
partial performance." 230 Cal.App.2d at 501. Flagship contends

1 that *B.C. Richter* does not support interpreting Section 4.5 as a  
2 waiver of Flagship's right to rescind, particularly in light of  
3 the fact that in *B.C. Richter*, there was no material breach by  
4 the other contracting party that thwarted performance. Flagship  
5 asserts:

6           Significantly, *B.C. Richter* had *completed the*  
7           *contract* and then sought to rescind the  
8           contract. (*Id.* at 502.) The court found  
9           that under these circumstances, the  
10          subcontractor had waived its right to  
11          rescind.

12          Flagship cites *Seaboard Surety Co. v. United States*, 355  
13          F.2d 139, 143 (9<sup>th</sup> Cir.1966), where the Ninth Circuit, in  
14          discussing *B.C. Richter*, stated that "[t]he subcontractors had a  
15          right to rescind after the cessation of certain progress  
16          payments, but elected to proceed with contract and completed  
17          performance."

18          Flagship also cites *Barton Properties, Inc. v. Superior*  
19          *Gunite Co.*, 2006 WL 541025 at \*7 (Cal.Ct.App.2006).

20          The dispute in *Barton Properties* was over paragraph 35 of a  
21          construction contract:

22               35. In the event of a dispute between the  
23               parties as to performance of the work, the  
24               interpretation of this contract, extra work,  
25               delay, disruption, or payment or nonpayment  
26               for work performed, the parties shall attempt  
              to resolve the dispute by negotiation. If  
              the dispute is not resolved, Contractor  
              agrees to Continue the work diligently to  
              completion and will neither rescind nor stop  
              the progress of the work, but will submit  
              such controversy to determination by a court  
              of competent jurisdiction after the project  
              has been completed.

1 *Id.* at \*5. The Court of Appeal, citing California Civil Code §  
2 1511 and *Peter Kiewit Sons' Co. v. Pasadena Junior College*, 59  
3 Cal.2d 241 (1963), that an owner who is a party to a construction  
4 contract is a creditor, ruled:

5 We conclude that where a general contractor  
6 (Barton Properties) materially breaches a  
7 contract so as to delay or prevent the  
8 performance of the subcontract (Superior  
9 Gunite) the subcontractor is not foreclosed  
10 from refusing to perform and rescinding the  
11 contract by reason of a contractual  
12 provision, such as paragraph 35, which  
13 requires a contractor not to rescind the  
14 contract or stop working but instead to  
15 'continue the work diligently to completion'  
and then 'submit [any] controversy  
[regarding]' 'performance of the work, the  
interpretation of this contract, extra work,  
delay, disruption, or payment or nonpayment  
for work performed' 'to determination by a  
court of competent jurisdiction after the  
project has been completed.' A contrary  
conclusion would impermissibly conflict with  
the controlling plain language of section  
1511, paragraph 1 ....

16 Barton Properties acknowledges the existence  
17 of this conflict. Its position is that the  
18 1965 amendment to section 1511, paragraph 1  
'added [a] clause permitting ... provisions'  
such as paragraph 35.

19 We note Barton Properties has cited no  
20 applicable authority in support of its  
21 position that contractual provisions such as  
22 paragraph 35 are authorized under section  
23 1511, paragraph 1. Its reliance is misplaced  
24 on *B.C. Richter Contracting Co. v.*  
25 *Continental Cas. Co.* (1964) 230 Cal.App.2d  
491 ... and *Michel & Pfeffer v. Oceanside*  
*Properties, Inc.* (1976) 61 Cal.App.3d 433.  
Neither case addressed section 1511,  
paragraph 1, much less its impact on a  
contractual provision such as paragraph 35  
....

26 *Id.* at \*6. The Court of Appeal then addressed Barton Properties'

1 contention that it was prejudiced by a jury instruction that it  
2 contended negated paragraph 35. In so ruling, the Court of  
3 Appeal stated:

4 And *B.C. Richter* is factually inapplicable  
5 and thus fails to support Barton Properties's  
6 position. As discussed above, *B.C. Richter*  
7 did not involve section 1511, paragraph 1 or  
8 its applicability to paragraph 35 or a  
9 similar contract provision, and its comments  
10 regarding such a provision were dicta. The  
11 court did not discuss whether section 1511,  
12 paragraph 1 rendered unenforceable a contract  
13 provision like paragraph 35. In [*B.C.*  
14 *Richter*], two subcontractors sued in quantum  
15 meruit for an amount greater than the  
16 contract price on the theory they were  
17 entitled to rescind the contract ... Their  
18 exclusive remedy, however, was for breach of  
19 contract because they affirmed the contract  
20 by completing their performance ... The *B.C.*  
21 *Richter* court characterized a clause in the  
22 contract of one subcontractor, which required  
23 it to complete its performance  
24 notwithstanding any dispute with the  
25 contractor, to be an 'advance waiver of any  
26 right to rescind after partial performance[,  
which meant] a breach of contract action  
[was] the subcontractor's exclusive remedy.'  
... But this was dicta because the trial  
court did not make any factual findings that  
the contractor had hindered the  
subcontractor's performance, and the  
subcontractor had performed completely.

*Id.* at \*7.

*Barton Properties* is not controlling. California Civil Code  
§ 1511 provides:

The want of performance of an obligation, or  
an offer of performance, in whole or in part,  
or any delay therein, is excused by the  
following causes, to the extent to which they  
operate:

1. When such performance or offer is  
prevented or delayed by the act of the

1 creditor, or by the operation of law, even  
2 though there may have been a stipulation that  
3 this shall not be an excuse; however, the  
4 parties may expressly require in a contract  
5 that the party relying on the provisions of  
6 this paragraph give written notice to the  
7 other party or parties, within a reasonable  
time after the occurrence of the event  
excusing performance, of an intention to  
claim an extension of time or of an intention  
to bring suit or any other similar or related  
intent, provided that the requirement of such  
notice is reasonable and just ....

8 As Excel notes, Flagship and Excel were tenant and landlord.  
9 Flagship makes no showing or argument that it was a creditor  
10 within the meaning of Section 1511.

11 The rules of contract construction support Flagship's  
12 position that Section 4.5 is not a waiver of rescission; the  
13 unavailability of rescission is never mentioned in Section 4.5  
14 and no evidence was presented that the parties intended that  
15 rescission of the lease be precluded based on Excel's material  
16 breach of the lease. Moreover, *B.C. Richter* and related cases  
17 contain continual performance obligations, despite an event of  
18 breach, which is the basis for a waiver of the right to rescind.  
19 Section 4.5 is expressly subject to exceptions "otherwise  
20 expressly set forth herein." Section 6.3 is such an express  
21 exception.

22 3. Rescission Voided Entire Lease.

23 Flagship argues that, because it rescinded the Lease, the  
24 entire Lease, including Section 4.5, is extinguished and cannot  
25 be enforced.

26 California Civil Code § 1688 provides that "[a] contract is

1 extinguished by rescission." "Rescission of a contract must be  
2 of the contract as a whole and not in part. It is the undoing of  
3 a thing and means that both parties to the contract are entirely  
4 released as if it had not been made." *Douglas v. Dahm*, 101  
5 Cal.App.2d 125, 128 (1950). Flagship refers to the November 19,  
6 2004 Memorandum Decision at 41:28-42:17, where the Court  
7 discussed the effect of rescission on contractual clauses:

8 Plaintiffs are correct in stating that  
9 rescission would void ordinary contractual  
10 clauses such as § 22.25. Once a contract is  
11 rescinded, all its provisions cease to have  
12 effect. See *Larsen v. Johannes*, 7 Cal.App.3d  
13 491, 501 (Cal.Ct.App. 1970) (citing *Lemle v.*  
14 *Barry*, 181 Cal. 1, 5 (Cal.1919)). ('When a  
15 contract is rescinded, it ceases to exist.  
16 If the action to rescind or an action based  
17 on an alleged rescission or abandonment is  
18 successful, the contract is forever ended and  
19 its covenants cannot thereafter be enforced  
20 by any action'). In an unpublished state  
21 court opinion, an analogous question was  
22 posed: 'The issue presented is elemental -  
23 may a defendant resist an action for  
24 rescission by relying on a liquidated damages  
25 provision of the contract the plaintiff is  
26 seeking to rescind? The answer is equally  
simple - no.' *BTS, Inc. v. Sonitrol Corp. of*  
*Contra Costa*, No. 1093591, 2002 WL 234889  
(Cal.App. 1 Dist., Feb. 19, 2002) ('rescinded  
contract is an extinguished contract meaning  
that it has ceased to exist and none of its  
provisions can be enforced by any party').

21 Excel responds that Flagship's position evades "the point  
22 entirely: § 4.5 bars rescission from the outset, so what *might*  
23 happen if Plaintiffs could rescind is meaningless." Excel  
24 asserts that Flagship's "circular argument" was rejected by the  
25 Court in the November 19, 2004 Memorandum Decision discussing the  
26 effect of rescission on contractual clauses quoted above. This

1 is belied by the express exceptions included in Sections 4.5 and  
2 6.3, which suspend the Lessor's remedies upon occurrence of the  
3 condition of the exception; to wit, Excel's violation of  
4 Flagship's exclusive use rights.

5  
6 4. Context of Lease as a Whole Does Not Support  
7 Interpreting Other Portions of Section 4.5 as Waiver of Right to  
8 Rescind.

9 Flagship argues that, looking to the Lease as a whole,  
10 Section 4.5 cannot be interpreted as a waiver of the right to  
11 rescind. Flagship notes that Section 4 of the Lease is captioned  
12 "Rent." The provisions of Section 4 are specifically directed at  
13 the Tenant's obligations to pay rent: Section 4.1 sets out the  
14 preliminary rent Flagship was obligated to pay from the time it  
15 entered into the Lease until the Golden Corral Restaurant opened  
16 for business; Section 4.2 sets out the basic rent after the  
17 restaurant opened; Section 4.3 provided for the amount of rent  
18 during the five-year option periods; Section 4.4 obligated  
19 Flagship to pay additional rent on demand; Section 4.6 provided  
20 Landlord the right to assign rent payments. Flagship argues that  
21 within the context of these provisions, Section 4.5, captioned  
22 "Triple Net Lease," provides what Excel would net from the rental  
23 payments. Flagship cites 6 Matthew Bender, California Real  
24 Estate Law & Practice, § 154.10[1], that a triple net lease  
25 provision assures the Landlord that "the tenant pays the taxes,  
26 the insurance, costs of repair, and costs of maintenance."

1 Flagship argues that Section 4.5 is a standard triple net lease  
2 provision which entitles the Landlord to rent net of these costs  
3 and "is essentially a financing device that gives the tenant the  
4 advantages of ownership without the investment of capital or  
5 direct obligation under a deed of trust and gives the owner of  
6 the property a return of his or her investment without the active  
7 responsibilities of investment management." *Id.*

8 Flagship refers to the portion of Section 4.5 providing:

9 *Except as otherwise expressly set forth in*  
10 *this Lease, this Lease shall continue in full*  
11 *force and effect, and the obligations of*  
12 *Tenant hereunder shall not be released,*  
13 *discharged or otherwise affected, by reason*  
14 *of any of the following: (a) any damage to or*  
15 *destruction of the Premises or any portion of*  
16 *either or any Taking of the Premises or any*  
17 *portion of either; (b) any restriction or*  
18 *prevention of or interference with any use of*  
19 *the Premises or any portion of either; or (c)*  
20 *any other occurrence whatsoever, whether*  
21 *similar or dissimilar to the foregoing, in*  
22 *each case, whether or not Tenant shall have*  
23 *notice or knowledge of any of the foregoing.*  
24 *[Emphasis added].*

25 Flagship argues that nothing in this language can be  
26 interpreted as a waiver of Flagship's right to rescind:

On its face, the language deals with physical  
interference or restrictions and is facially  
not applicable to the material breach of the  
lease at issue in this case. By definition,  
the provision provides that the lease would  
continue in force notwithstanding the  
occurrence of a condition subsequent.  
Specifically, there is no language contained  
within Section 4.5 that could reasonably be  
interpreted as a limitation on a tenant's  
right to rescind.

Flagship argues that the purpose of the provision in Section

1 4.5 that

2 Tenant's Basic Rent and Additional Rent shall  
3 be absolutely net to Landlord, so that this  
4 Lease shall yield to Landlord the full amount  
5 of the installments of Basic Rent and  
6 Additional Rent throughout the Term, and  
7 shall be paid without assertion of any  
counterclaim, set off, deduction or defense  
and without abatement, suspension, deferment,  
diminution, reduction or refund of any kind,  
*except as expressly set forth herein,*  
[emphasis added]

8 is "to preclude a tenant from interposing a counterclaim in any  
9 action or proceeding brought by the landlord for rent, or for  
10 possession based on nonpayment," quoting 1 Friedman on Leases §  
11 5:1.2[A] (5<sup>th</sup> ed. 2009). Flagship asserts that "[t]his  
12 interpretation flows from the language of the sentence, which  
13 uses the words, 'counterclaim, set off, deduction, or defense,'  
14 and does not use the words typically associated with offensive  
15 action, such as 'cause of action' 'claims' etc." Flagship argues  
16 that this portion of Section 4.5 should be contrasted with  
17 Section 12.1, captioned "General Indemnity:"

18 Tenant shall protect, indemnify, defend and  
19 hold Landlord ... harmless from and against  
20 any and all liabilities, obligations, claims,  
21 damages, penalties, causes of action,  
22 judgments, costs and expenses ... incurred by  
23 or asserted against Landlord ... during the  
24 Term hereof, arising in connection with or  
25 resulting from (a) this Lease; (b) any  
26 accident or injury to or death of persons or  
loss of or damage to property occurring on or  
about the Premises or any portion thereof;  
(c) any use or condition of the Premises or  
any portion thereof; (d) any failure by  
Tenant to perform or comply with any terms of  
this Lease, or (e) any negligence, willful  
misconduct or tortious act or omission on the  
part of Tenant or any Subtenant ... If any

1           action, suit or proceeding is brought against  
2           Landlord ... by reason of any of the  
3           foregoing, Tenant, upon Landlord's request,  
4           shall, at Tenant's sole cost and expense,  
5           defend such action, suit or proceeding with  
6           counsel designated by Landlord. The  
7           obligations of Tenant under this Paragraph  
8           shall survive the expiration or earlier  
9           termination of this Lease.

10       Flagship, noting that Section 12.1 uses the terms "any and all  
11       liabilities, obligations, claims, damages, penalties, causes of  
12       action, judgments, costs and expenses," argues that "[u]nder the  
13       rule of construction that the expression of one thing is the  
14       exclusion of another, and in light of Section 4.5's use of the  
15       words typically associated with defenses, such as 'set off,  
16       deduction, defense, abatement, counterclaim' etc., this sentence  
17       cannot be interpreted as applying to offensive claims that  
18       Flagship would have against Defendants for their breach of the  
19       Lease."     Flagship cites *Steven v. Fidelity & Cas. Co. of New*  
20       *York*, 58 Cal.2d 862, 870 (1962):

21           The crucial issue resolves into whether the  
22           limitation of that extension to 'land  
23           conveyances' sufficiently overcomes the  
24           normal expectation that coverage would extend  
25           to *any reasonable form of substitute*  
26           *conveyance*. The clause clearly does not  
             specifically exclude substitute emergency  
             aircraft; it does not mention nonland  
             conveyances at all. An inference of such  
             noncoverage could arise only with the aid of  
             the rule of construction *expressio unius est*  
             *exclusio alterius*: i.e., that mention of one  
             matter implies the exclusion of all others.

             We do not believe the application of the  
             maxim can resolve the present case. The  
             maxim serves as an aid to resolve the  
             ambiguities of a contract. If we invoke the  
             *expressio unium* approach, we must necessarily

1           thereby recognize the ambiguity of the  
2           contract; in that event other legal  
3           techniques for the resolution of ambiguities,  
4           including the rule that they should be  
5           interpreted against the draftsman, also come  
6           into play. Thus *McNee v. Harold Hensgen &*  
7           *Associates* (1960) 178 Cal.App.2d 881 ...  
8           holds that if the applicability of a contract  
9           provision can be determined only by use of  
10          the maxim *expressio unius*, the contract is  
11          ambiguous, and extrinsic evidence is  
12          therefore admissible to prove the intent of  
13          the parties.

14       Flagship further asserts that the "and shall be paid" clause of  
15       Section 4.5 refers only to the payment of rent by Flagship and,  
16       standing alone, cannot be construed as a waiver of any right to  
17       rescind the Lease based on Excel's breach of the exclusive use  
18       provision.

19           Finally, Flagship refers to the portion of Section 4.5:  
20       "Under no circumstances whether now existing or hereafter  
21       arising, or whether beyond the present contemplation of the  
22       parties, shall Landlord be required to make any payment or refund  
23       of any kind whatsoever or be under any obligation or liability  
24       hereunder, except as expressly set forth herein." Flagship  
25       argues that this portion of Section 4.5 is not a waiver of the  
26       right to rescind by the Tenant for a material breach of the  
27       Lease:

28           This sentence of Section 4.5 plainly sets out  
29           the obligations of the Landlord to refund or  
30           pay Flagship 'hereunder' i.e., *under the*  
31           *Lease*, but has no facial applicability to any  
32           claims Flagship may have against the Landlord  
33           for its breach of its obligations under the  
34           Lease.

35       Flagship again notes that this portion of Section 4.5 does not

1 use the terms damages, judgments, causes of action, or other  
2 similar language used in the indemnity section, Section 12.1.  
3 Flagship refers to Section 15.1(a), which provides that, in the  
4 event of a total Taking of the Premises, "this Lease shall  
5 terminate as of the date of the Taking and the Basic Rent and  
6 Additional Rent theretofore paid or then payable shall be  
7 apportioned and paid up to the date of termination and any  
8 unearned Basic Rent or Additional Rent shall be refunded to  
9 Tenant." Flagship argues that the "payment or refund" sentence  
10 in Section 4.5 cannot be interpreted as waiving Flagship's right  
11 to sue Excel for rescission of the Lease based on Excel's  
12 material breach of the exclusive use provision. Citing *Runyan v.*  
13 *Pacific Air Industries, Inc.*, 2 Cal.3d 304, 310-319 (1970),  
14 Flagship asserts that, in the face of rescission, the plaintiff  
15 is awarded restitution damages, not a refund.

16 Excel responds that the whole of the Lease is consistent  
17 with its position that Flagship's obligations are separate and  
18 independent covenants and that Section 4.5 otherwise bars  
19 rescission. Excel contends that Flagship attempts to skirt the  
20 legal effect of independent covenants and reads the language of  
21 Section 4.5 "so technically and narrowly that the results are  
22 ridiculous." Excel refers to Section 14.3 of the Lease, in the  
23 section captioned "Damage by Fire or Casualty:"

24 Except as expressly provided in this Lease,  
25 Tenant's obligation to make payments of Basic  
26 Rent, Additional Rent and all other charges  
hereunder, except to the extent Landlord is  
actually reimbursed by the proceeds of rental

1 value insurance, and to perform all its  
2 covenants and conditions shall not be  
3 affected by any damage or destruction of the  
4 Premises or the improvements or replacements  
5 thereof. Tenant hereby waives the provisions  
of any statute or law now or hereafter in  
effect which is contrary to the foregoing  
obligation of Tenant, or which relieves  
Tenant therefrom.

6 Excel asserts that, "[f]ollowing Plaintiffs' absurd logic,  
7 Plaintiffs could rescind the entire Ground Lease in the event of  
8 damage to its Improvements, because the word 'rescission' is not  
9 specifically stated."

10 However, for the reasons stated *supra*, Section 4.5 cannot be  
11 construed to preclude rescission because of Excel's material  
12 breach of the lease. Section 4.5 by its terms provides that the  
13 tenant's obligation to pay rent under the lease is an independent  
14 covenant. Section 4.5 does not refer in any way to the  
15 landlord's obligations to the tenant under the lease. The jury  
16 specifically found that Excel's breach of the exclusive use  
17 provision in Section 6.3 of the lease was material.

18 5. Defendants' Conduct and Performance Shows They  
19 Never Interpreted Section 4.5 as Preventing the Remedy of  
20 Rescission.

21 Flagship argues that Defendants' conduct with respect to  
22 Section 4.5 "is not reasonably interpreted as a waiver of  
23 rescission."

24 Flagship refers to the "principle of practical  
25 construction." Flagship cites *Crestview Cemetary Ass'n v.*  
26 *Dieden*, 54 Cal.2d 744, 753-754 (1960):

1 That the actions of the parties should be  
2 used as a reliable means of interpreting an  
3 ambiguous contract is, of course, well  
4 settled in our law ... 'The acts of the  
5 parties under the contract afford one of the  
6 most reliable means of arriving at their  
7 intention; and, while not conclusive, the  
8 construction thus given to a contract by the  
9 parties before any controversy has arisen as  
10 to its meaning will, when reasonable, be  
11 adopted and enforced by the courts.' ... 'The  
12 reason underlying the rule is that it is the  
13 duty of the court to give effect to the  
14 intention of the parties where it is not  
15 wholly at variance with the correct legal  
16 interpretation of the terms of the contract,  
17 and a practical construction placed by the  
18 parties upon the instrument is the best  
19 evidence of their intention ....'

20 ...

21 This rule of practical construction is  
22 predicated on the common sense concept that  
23 'actions speak louder than words.' Words are  
24 frequently but an imperfect medium to convey  
25 thought and intention. When the parties to a  
26 contract perform under it and demonstrate by  
their conduct that they knew what they were  
talking about the courts should enforce that  
intent.

Appellants correctly claim that this doctrine  
of practical construction can only be applied  
when the contract is ambiguous, and cannot be  
used when the contract is unambiguous. That  
is undoubtedly a correct general statement of  
the law ... But the question involved in such  
cases is ambiguous to whom? Words frequently  
mean different things to different people.  
Here the contracting parties demonstrated by  
their actions that they knew what the words  
meant and were intended to mean. Thus, even  
if it be assumed that the words standing  
alone might mean one thing to the members of  
this court, where the parties have  
demonstrated by their actions and performance  
that to them the contract meant something  
quite different, the meaning and intent of  
the parties should be enforced. In such a  
situation the parties by their actions have

1 created the 'ambiguity' required to bring the  
2 rule into operation. If this were not the  
3 rule the courts would be enforcing one  
4 contract when both parties have demonstrated  
5 that they meant and intended the contract to  
6 be quite different.

7  
8 Flagship argues that, under the principle of practical  
9 construction, the Court can consider Excel's conduct after  
10 Flagship's notice of rescission in April 2001, until the dispute  
11 regarding Section 4.5 arose, after the jury's verdict was  
12 returned in Flagship's favor. Flagship argues that, underlying  
13 the rule of practical construction is the recognition that a  
14 party may modify its conduct with respect to the disputed issue  
15 following a disagreement. Flagship asserts that, given Excel's  
16 position that Section 4.5 expressly bars rescission, it is  
17 logical to expect that Excel would have asserted this bar at the  
18 time the parties' dispute arose in 2000 and again in response to  
19 the notice of rescission. Excel never contended that Section 4.5  
20 constituted a waiver of Flagship's right to rescind at any time  
21 before this litigation commenced or at any time before this case  
22 was submitted to the jury: "Clearly, Defendants' assertion that  
23 Section 4.5 bars rescission was an afterthought."

24  
25 Excel responds that Flagship fundamentally misunderstands  
26 the principle of practical construction, which focuses on how the  
parties behaved before any controversy erupted:

If this doctrine has any application here, it  
supports Excel's position, not Plaintiffs.'  
This is so because Excel believed that the  
Four Seasons' use would not violate  
Plaintiffs' lease and Excel acted  
accordingly. Obviously, from Excel's point

1 of view at the time, the remedy of rescission  
2 was irrelevant because there was no breach.

3 It is Excel that misinterprets the doctrine. Excel did not  
4 assert that Flagship had no contractual right to rescind the  
5 lease and was limited to damages when Flagship gave notice of  
6 rescission. Excel only made this contention after the jury had  
7 ruled that Excel had materially breached the exclusive use  
8 provision of the lease. If Excel truly believed that rescission  
9 was not an available remedy, Excel would have so advised Flagship  
10 when Flagship gave notice of rescission and sought rescission as  
11 a remedy in its complaint. If Excel had believed in the bar  
12 defense, its conduct is further inconsistent as it never brought,  
13 before or during trial, a dispositive motion on this issue.

14 6. No California Case has Upheld Advance Waiver of  
15 Rescission for Material Breach.

16 In response to Excel's contention that Section 4.5 is an  
17 "express" waiver of Flagship's right to rescind the Lease for  
18 Excel's material breach and citing *Medico-Dental Bldg. Co. of Los*  
19 *Angeles v. Horton & Converse, supra*, 21 Cal.2d at 434, Flagship  
20 asserts that a material breach occurs when the breach "will  
21 defeat the entire object of the lessee in entering into the  
22 lease." Flagship contends that the California Supreme Court  
23 articulated the concept of a material breach:

24 While consistent with practical  
25 considerations, it is said that a breach of a  
26 contractual right in a trivial or  
inappreciable respect will not justify  
rescission of the agreement by the party  
entitled to the benefit in question, a

1 default in performance will not be tolerated  
2 if it is so dominant or pervasive as in any  
3 real or substantial measure to frustrate the  
4 purpose of the undertaking ... But where, as  
5 here, the covenant of the lessor is of such  
6 character that its breach will defeat the  
7 entire object of the lessee in entering into  
8 the lease, such as rendering his further  
9 occupancy of the premises a source of  
10 continuing financial loss incapable of  
11 satisfactory measurement in damages, it must  
12 be held that the covenant goes to the root of  
13 the consideration for the lease upon the  
14 lessee's part.

15 *Id.* at 433-434. Flagship asserts that Excel's contention that  
16 Flagship waived the right to rescind the agreement based on  
17 Excel's breach of the exclusive use provision would "defeat the  
18 entire object of the lessee in entering into the lease."  
19 Flagship refers to Marvin Reiche's trial testimony that he would  
20 not have entered into the Lease but for the exclusive use granted  
21 to Flagship pursuant to the exclusive use provision.

22 See discussion *infra* re Flagship's argument that there is no  
23 authority indicating that California Courts would interpret  
24 Section 4.5 as an advance waiver of rescission for a material  
25 breach of a lease, specifically, the *B.C. Richter Contracting Co.*  
26 and *Michel & Pfeffer* decisions.

Flagship further argues that interpreting Section 4.5 as  
preventing rescission for a material breach is contrary to public  
policy reflected in California law. Flagship cites *Philippine*  
*Airlines, Inc. v. McDonnell Douglas Corp.*, 189 Cal.App.3d 234,  
237-238 (1987):

[C]ontractual clauses seeking to limit  
liability will be strictly construed and any

1 ambiguities resolved against the party  
2 seeking to limit its liability for  
negligence.

3 'The language of an agreement in order to  
4 exclude liability for negligence must be  
"clear and explicit" and "free of ambiguity  
5 or obscurity." ... The law generally looks  
with disfavor on attempts to avoid liability  
6 or to secure exemption from one's own  
negligence ... The law requires exculpatory  
7 clauses to be strictly construed against the  
party relying on them ....

8 Flagship also cites *Queen Villas Homeowners Ass'n v. TCB Property*  
9 *Management*, 149 Cal.App.4th 1, 5 (2007):

10 Where a two-party contract purportedly  
11 releases one side from liability to the other  
(e.g., *Saenz v. Whitewater Voyages, Inc.*  
12 (1991) 226 Cal.App.3d 758 ... [contract in  
which plaintiff's decedent expressly assumed  
13 the risk of white water rafting and relieved  
defendant rafting company of liability]),  
14 courts must look for clear, unambiguous and  
explicit language not to hold the released  
15 party liable. As the *Saenz* court nicely put  
it: 'Everyone agrees that drafting a legally  
16 valid release is no easy task. Courts have  
criticized and struck down releases if the  
17 language is oversimplified, if a key word is  
noted in the title but not the text, and if  
18 the release is too lengthy or too general, to  
name a few deficiencies ... However, we must  
19 remember that "[t]o be effective, a release  
need not achieve perfection ... It suffices  
20 that a release be clear, unambiguous, and  
explicit, and that it express an agreement  
21 not to hold the released party liable for  
negligence.'"

22 Flagship asserts that the law of indemnity provisions is similar.  
23 *See Prince v. Pacific Gas and Electric Co.*, 45 Cal.4th 1151, 1158  
24 (2009):

25 In the context of noninsurance indemnity  
26 agreements, if a party seeks to be  
indemnified for its own active negligence, or

1           regardless of the indemnitor's fault, the  
2           contractual language on the point 'must be  
3           particularly clear and explicit, and will be  
4           construed against the indemnitee.'

5       Flagship notes that California law bars the prior release of  
6       liability for gross negligence, *City of Santa Barbara v. Superior*  
7       *Court*, 41 Cal.4th 747, 758 (2007), or for negligent  
8       misrepresentations, *Blankenheim v. E.F. Hutton Co.*, 217  
9       Cal.App.3d 1463, 1473 (1990). Relying on this authority,  
10      Flagship contends:

11           As the foregoing reveals, California has a  
12           strong public policy of requiring exculpatory  
13           clauses, to the extent they are valid, to  
14           clearly and unequivocally advise the  
15           exculpating party of exactly what conduct of  
16           Defendants is subject to exculpation. As in  
17           the context of indemnity and releases,  
18           rescission can occur for a variety of  
19           circumstances. In this regard, Civil Code §  
20           1689 recognizes a range of circumstances  
21           under which a contract may be rescinded, from  
22           a consensual rescission to unilateral  
23           rescissions based on mistake, fraud or  
24           material failure of consideration ... The  
25           California Supreme Court has noted the range  
26           of circumstances upon which rescission could  
          be based. (See *Runyan*, 2 Cal.3d 317). As  
          such, there is a continuum of circumstances  
          under which a contract may be rescinded from  
          non-culpable and to culpable (i.e. a material  
          breach) conduct.

27      Flagship argues that Section 4.5 "does not remotely meet the  
28      standard of a clear and unequivocal exculpatory provision"  
29      because "nothing in the language of Section 4.5 specifically  
30      mentions excusing the Defendants from a future material breach."  
31      Moreover, under this principle, given the prolixity of remedies  
32      court to be barred in Section 4.5, if Excel truly sought to bar

1 the right of rescission, if could have said so.

2       Flagship's public policy analysis is inapposite. Section  
3 4.5 is not a release or an indemnity provision. Excel is arguing  
4 that Section 4.5 bars Flagship from the remedy of rescission even  
5 though Excel breached the Lease. No case is cited by Flagship  
6 that suggests that California Courts strike down such a provision  
7 or interpretation on the ground that it violates a fundamental  
8 public policy of California.

9               7. Unconscionable.

10       Flagship argues that interpreting Section 4.5 as a waiver of  
11 rescission would make Section 4.5 unconscionable as applied.

12       In the November 19, 2004 Memorandum Decision, the Court  
13 addressed Flagship's contention that Sections 4.5 and 22.25 are  
14 unconscionable as applied:

15               E. Unconscionability.

16       Plaintiffs claim that the Lease clauses are  
17 'unconscionable in light of the context of  
18 this transaction' and cannot be applied ...  
19 Defendants cite *Markborough California, Inc.*  
20 *v. Superior Court* for the proposition that a  
21 limitation of liability provision is  
22 enforceable ... That case also says that  
23 'although these provisions generally have  
24 been upheld as reasonable and valid,  
25 nonetheless, because they do in fact  
26 exculpate or insulate a party, at least to a  
certain extent, from liability for his or her  
own wrongful or negligent acts ... such  
provisions may be declared unenforceable if  
the provision is unconscionable or otherwise  
contrary to public policy.' *Markborough*  
*California, Inc. v. Superior Court*, 227  
Cal.App.3d 705, 714-715 (Cal.Ct.App.1991).  
This is an affirmative defense that was not  
pled or preserved as an issue for trial in  
the Pretrial Order.

1 (Doc. 353, 44:1-45:15). The Court then ruled that Flagship was  
2 not entitled to a jury trial on the issue of unconscionability,  
3 concluding that the case authority cited by Flagship did not  
4 establish a right to jury trial and:

5 Most importantly, the issue was not reserved  
6 for trial and an afterthought defense to  
7 enforcement of the contract cannot be  
8 countenanced. See *Canal Electric Co. v.*  
9 *Westinghouse Electric Co.*, 973 F.2d 988, 997-  
10 98 (1<sup>st</sup> Cir.1992) (raising unconscionability  
11 for the first time on appeal is untimely);  
12 *Oakwood Mobile Homes, Inc. v. Stevens*, 204  
13 F.Supp.2d 947, 951 (D.W.Va.2002) (raising  
unconscionability for the first time on the  
day of mandatory arbitration hearing is too  
late; defense waived). Cf *Beaver v. Figgie*  
*Intern. Corp.*, 849 F.2d 1472 (6<sup>th</sup> Cir.1988)  
(unpublished opinion) (on remand after grant  
of summary judgment reversed, issue of  
unconscionability now waived though it had  
never been previously raised).

14 (Doc. 353, 45:17-48:1). With regard to Flagship's claim of  
15 unconscionability as a matter of law, the Court ruled:

16 *Marin Storage & Trucking, Inc. v. Benco*  
17 *Contracting & Eng'g, Inc.*, 89 Cal.App.4th  
18 1042, 1052-1053 (Cal.Ct.App.2001) (citing *A&M*  
*Produce Co. v. FMC Corp.*, 135 Cal.App.3d 473,  
486-87 (Cal.Ct.App.1982) discusses  
unconscionability:

19  
20 Unconscionability has both a  
21 procedural and a substantive  
22 element. The procedural element  
23 focuses [on] 'oppression' and  
24 'surprise.' "'Oppression" arises  
25 from an inequality of bargaining  
26 power which results in no real  
negotiation and "an absence of  
meaningful choice." "Surprise"  
involves the extent to which the  
supposedly agreed-upon terms are  
hidden in a prolix printed form  
drafted by the party seeking to  
enforce the disputed terms.' The

1 substantive element has to do with  
2 the effects of the contractual  
3 terms and whether they are  
4 unreasonable. Because a contract  
5 is largely an allocation of risks,  
6 a contractual provision is  
7 'substantively suspect if it  
8 reallocates the risks in an  
9 objectively unreasonable or  
10 unexpected manner.'

11 To be unenforceable, a contract  
12 must be both procedurally and  
13 substantively unconscionable,  
14 although the greater the procedural  
15 unconscionability, the less  
16 unreasonable the risk allocation  
17 that will be tolerated.

18 Plaintiffs assert that Marvin Reiche (who  
19 negotiated the lease on behalf of Plaintiffs)  
20 had little bargaining power ... As evidence  
21 Plaintiffs point out that the Lease is based  
22 on a pre-existing Excel lease negotiated with  
23 another restaurant ... Even assuming this  
24 fact to be true, Plaintiffs have not  
25 demonstrated 'oppression,' which requires  
26 circumstances where the oppressed party was  
not in a position to negotiate and given no  
meaningful choice. Defendants assert that  
Plaintiffs had a choice since they were  
considering multiple sites for their proposed  
restaurant ... Plaintiffs were experienced  
and sophisticated restaurant operators. The  
Lease was negotiated and Plaintiffs insisted  
on the exclusive use clause. There is no  
evidence that the Briggsmore Plaza was the  
only site under consideration or that the  
Lease was offered on a take it or leave it  
basis. Defendants also point out that the  
Lease was actively negotiated over a period  
of months and Plaintiffs 'submitted extensive  
comments on the draft.' ....

23 Plaintiffs rely on *A&M Produce Co. v. FMC*  
24 *Corp.* to show that even contracts negotiated  
25 by experienced parties can be unconscionable  
26 where there is great imbalance of bargaining  
power ... The factual scenario of *A&M Produce*  
is significantly different from the one at  
hand since the plaintiff was not permitted to

1 negotiate the terms of the contract. *A&M*  
2 *Produce Co. v. FMC Corp.*, 135 Cal.App.3d 473,  
3 491 (Cal.Ct.App.1982). Plaintiffs did not  
4 adduce evidence that they were unable to  
negotiate the terms of the Lease. Plaintiffs  
did not show any other sites were unavailable  
or that they were without choice.

5 (Doc. 353, 48:3-49:21). As to the element of surprise as to  
6 Section 4.5, the Court ruled:

7 With respect to § 4.5, the Lease shows that  
8 the parties modified the provision, striking  
9 out the term 'or the Access Area' several  
10 times. These changes were ratified by  
initials 'MGR' (Marvin G. Reiche) in the  
margins ... Plaintiffs cannot claim that §  
4.5 escaped their notice.

11 (Doc. 353, 51:10-15).

12 Flagship contends that the Court's discussion of  
13 unconscionability in the November 19, 2004 Memorandum Decision  
14 was made only after finding that Flagship had not reserved the  
15 issue for trial with respect to the factual issues surrounding  
16 unconscionability of Section 4.5 and, therefore, the Court's  
17 "prior observations were dicta." Flagship refers to the Ninth  
18 Circuit's remand that the Court consider whether the Lease "in  
19 its entirety, allows for rescission and whether California law  
20 would give effect to the lease's limitations on remedies in these  
21 circumstances." Flagship asserts that the Ninth Circuit's  
22 mandate re-opens the issue of unconscionability in interpreting  
23 Section 4.5, citing *United States v. Kellington*, 217 F.3d 1084,  
24 1093 (9<sup>th</sup> Cir.2000) ("According to the rule of mandate, although  
25 lower courts are obliged to execute the terms of a mandate, they  
26 are free as to 'anything not foreclosed by the mandate.'").

1 Flagship further contends that the Ninth Circuit's mandate  
2 "suggests that this Court construed the pretrial order too  
3 narrowly in finding that Plaintiffs did not 'preserve' the issue  
4 of unconscionability for trial." Flagship asserts:

5           Specifically, the pretrial order asserted  
6           that Plaintiffs were seeking rescission and  
7           also that Plaintiffs sought declaratory  
8           relief with respect to the parties' rights  
9           and obligations under the Lease. (Doc. No.  
10           214, Pretrial Order at 14:10-15:21.) This  
11           statement of the relief sought, including a  
12           declaration of the rights of the parties,  
13           would seem sufficient to preserve the issue  
14           of unconscionability, with respect to  
15           Defendants' post-trial proffer of an  
16           interpretation of Section 4.5. If, as the  
17           court of appeal found, the statement of  
18           issues, facts and contentions in the pretrial  
19           order were sufficient to preserve Defendants'  
20           right to argue an interpretation of the Lease  
21           that they never presented before the jury's  
22           verdict was announced, it is also sufficient  
23           to preserve Plaintiffs' right to rebut such  
24           an argument, including the argument that  
25           Section 4.5 is unconscionable if interpreted  
26           as a waiver of rescission.

          Although the Ninth Circuit's ruling in this case addressed  
the Court's invocation of judicial estoppel to bar Excel from  
contending that Section 4.5, Flagship's point that the Ninth  
Circuit's mandate allows consideration of the issue of  
unconscionability is well-taken because the Court is mandated to  
determine "whether the contract, in its entirety, allows for  
rescission and whether California law would give effect to the  
lease's limitations on remedies in these circumstances."

          California Civil Code § 1670.5(a) provides:

          If the court as a matter of law finds the  
contract or any clause of the contract to

1 have been unconscionable at the time it was  
2 made the court may refuse to enforce the  
3 contract, or it may enforce the remainder of  
4 the contract without the unconscionable  
clause, or it may so limit the application of  
any unconscionable clause as to avoid any  
unconscionable result.

5 Flagship argues that interpreting Section 4.5 as a waiver of  
6 rescission would render Section 4.5 unconscionable both  
7 substantively and procedurally, with the element of substantive  
8 unconscionability predominating over the element of procedural  
9 unconscionability.

10 As explained in *Gentry v. Superior Court*, 42 Cal.4th 443  
11 (2007), addressing the Court of Appeal's conclusion that a 30-day  
12 opt-out provision in an arbitration agreement was procedurally  
13 unconscionable:

14 "" To briefly recapitulate the principles of  
15 unconscionability, the doctrine has ""both a  
16 'procedural' and a 'substantive' element,"  
17 the former focusing on ""'oppression'"" or  
18 ""'surprise'"" due to unequal bargaining power,  
19 the latter on ""'overly harsh'"" or ""'one-  
20 sided'"" results." ... The procedural element  
21 of an unconscionable contract generally takes  
22 the form of a contract of adhesion, ""which,  
23 imposed and drafted by the party of superior  
24 bargaining strength, relegates to the  
25 subscribing party only the opportunity to  
26 adhere to the contract or reject it."" ...  
Substantively unconscionable terms may take  
various forms, but may generally be described  
as unfairly one-sided.""

As we have further explained: ""The  
prevailing view is that [procedural and  
substantive unconscionability] must both be  
present in order for a court to exercise its  
discretion to refuse to enforce a contract or  
clause under the doctrine of  
unconscionability." ... But they need not be  
present in the same degree. "Essentially a

1 sliding scale is invoked which disregards the  
2 regularity of the procedural process of the  
3 contract formation, that creates the terms,  
4 in proportion to the greater harshness or  
5 unreasonableness of the substantive terms  
6 themselves." ... In other words, the more  
substantively oppressive the contract term,  
the less evidence of procedural  
unconscionability is required to come to the  
conclusion that the term is unenforceable,  
and vice versa.' ....

7 As the above suggests, a finding of  
8 procedural unconscionability does not mean  
9 that a contract will not be enforced, but  
10 rather that courts will scrutinize the  
11 substantive terms of the contract to ensure  
12 they are not manifestly unfair or one-sided  
13 ... [T]here are degrees of procedural  
14 unconscionability. Although certain terms in  
15 these contracts may be construed strictly,  
16 courts will not find these contracts  
17 substantively unconscionable, no matter how  
18 one-sided the terms appear to be. (See,  
19 e.g., *Nunes Turfgrass, Inc. v. Vaughn-Jacklin*  
20 *Seed Co.* (1988) 200 Cal.App.3d 1518, 1538-  
21 1539 ... [liability limitation negotiated by  
two commercial entities upheld].) Contracts  
of adhesion that involve surprise or other  
sharp practices lie on the other side of the  
spectrum. (See, e.g., *Ellis v. McKinnon*  
*Broadcasting Co.* (1993) 18 Cal.App.4th 1796,  
1804 ... [party told that signing contract  
was 'mere formality' to conceal oppressive  
forfeiture provision].) Ordinary contracts  
of adhesion, although they are indispensable  
facts of modern life that are generally  
enforced ... contain a degree of procedural  
unconscionability even without any notable  
surprises, and 'bear within them the clear  
danger of oppression and overreaching.' ....

22 Thus, a conclusion that a contract contains  
23 no element of procedural unconscionability is  
24 tantamount to saying that, no matter how one-  
25 sided the contract terms, a court will not  
26 disturb the contract because of its  
confidence that the contract was negotiated  
freely, that the party subject to a seemingly  
one-sided term is presumed to have obtained  
some advantage from conceding the term or

1           that, if one party negotiated poorly, it is  
2           not the court's place to rectify these kinds  
          of errors or asymmetries.

3   42 Cal.4th at 468-470.

4           Flagship again relies primarily on *A&M Produce Co. v. FMC*  
5   *Corp.*, 135 Cal.App.3d 473 (1982). A&M brought suit against FMC  
6   from which it had bought a weight sizing machine for use in  
7   processing plaintiff's tomato crop, alleging breach of express  
8   and implied warranties. The trial court ruled that clauses in  
9   FMC's preprinted contract disclaiming all warranties and  
10   excluding consequential damages were unconscionable. The Court  
11   of Appeal affirmed. Flagship relies on the following statement  
12   from *A&M Produce Corp.*:

13           Another factor supporting the trial court's  
14           determination involves the avoidability of  
15           damages and relates directly to the  
16           allocation of risks which lie at the  
17           foundation of the contractual bargain. It  
18           has been suggested that '[r]isk shifting is  
19           socially expensive and should not be  
20           undertaken in the absence of a good reason.  
21           An even better reason is required when to so  
22           shift is contrary to a contract freely  
          negotiated.' ... But as we noted previously,  
          FMC was the only party reasonably able to  
          prevent this loss by not selling A & M a  
          machine inadequate to meet its expressed  
          needs ... 'If there is a type of risk  
          allocation that should be subjected to  
          special scrutiny, it is probably the shifting  
          to one party of a risk that only the other  
          party can avoid.' ....

23   135 Cal.App.3d at 493.

24           Flagship argues that, according to Excel, Section 4.5 is not  
25   a reciprocal provision; it applies only to the tenant's  
26   obligations and does not bar any remedy by the landlord.

1 Flagship refers to Section 18.2(c) of the Lease:

2 18. EVENTS OF DEFAULT: REMEDIES

3 ...

4 18.2 Remedies.

5 ...

6 (c) If an Event of Default shall  
7 occur, then, in addition to any other rights  
8 or remedies available to Landlord at law or  
9 in equity, Landlord shall have the right to  
10 perform some or all of Tenant's Obligations  
11 which are then in default, without further  
notice to Tenant. In such event, any and all  
costs incurred by Landlord therefor  
(including, without limitation, reasonable  
attorney's fees and expenses) shall be  
payable by Tenant to Landlord upon demand.

12 Flagship argues that Excel's interpretation of the Lease is that  
13 Flagship waived its right to rescind in the event of Excel's  
14 material breach, but Excel maintained the right to all equitable  
15 remedies, including rescission, in the event of Flagship's  
16 breach. Citing *Money Store Investment Corp. v. Southern*  
17 *California Bank*, 98 Cal.App.4th 722, 728 (2002), Flagship argues  
18 that "such an imbalance in the parties' rights to rescind the  
19 agreement renders the Lease subject to attack for the lack of  
20 mutuality of obligation."

21 Flagship's reliance on the *Money Store Investment Corp.* to  
22 establish that Section 4.5 as construed by Excel is  
23 unconscionable, is misplaced. In *Money Store Investment Corp.*,  
24 the Court of Appeal stated:

25 The Bank asserts that the agreement was  
26 illusory because the Money Store's  
instructions 'reserved the right to withdraw

1 or amend these instructions at any time prior  
2 to the close of escrow.' The Bank is correct  
3 on its general point of law: 'Where a  
4 contract imposes no definite obligation on  
5 one party to perform, it lacks mutuality of  
6 obligation. It is elementary that where  
7 performance is optional with one of the  
8 parties no enforceable obligation exists....'  
9 ...

6 A corollary to that rule exists, however. An  
7 agreement that is otherwise illusory may be  
8 enforced where the promisor has rendered at  
9 least partial performance ... The Money Store  
performed. It provided the loan money  
necessary to complete the sale. Performance  
cured any illusory aspect of the agreement.

10 Here, Flagship does not argue that the Lease was illusory;  
11 rather, Flagship argues that Section 4.5, as construed by Excel,  
12 should not be enforced because of unconscionability.

13 Flagship asserts that Excel's interpretation of Section 4.5  
14 allocates the risk of Excel's failure to honor their promise of  
15 an exclusive buffet restaurant in the shopping center to  
16 Flagship. Flagship argues:

17 [Excel's] interpretation of Section 4.5 ...  
18 means that Flagship agreed to remain in a  
19 contract with Defendants regardless of  
20 Defendants' material breach; and that  
21 Flagship and the Reiches agreed to spend \$2  
22 million constructing a building on  
23 Defendants' property, with no ability to  
24 recoup the loss from Defendants in the event  
25 of Defendants' material breach of the Lease.  
26 In this regard, Defendants offered no  
evidence at trial that the parties intended  
Section 4.5 to operate in that fashion, or  
that the Reiches understood that Section 4.5  
meant that the Defendants could breach the  
exclusive [sic] immediately, and Flagship  
would be stuck with the Lease. This result,  
like the preclusion of consequential damages  
in *A&M Produce* is substantively  
unconscionable and shocking to the

1 conscience.

2 Flagship fails to demonstrate procedural unconscionability.  
3 As concluded in the November 19, 2004 Memorandum Decision, the  
4 Lease was negotiated on both sides by sophisticated, experienced  
5 parties. That Flagship did not know or understand that Excel  
6 would attempt to construe Section 4.5 to preclude rescission of  
7 the lease by Flagship because of Excel's breach of Section 6.3's  
8 exclusive use provision does not establish procedural  
9 unconscionability.

10 8. Jury's Finding of Material Breach Defeats  
11 Independent Covenant.

12 Flagship argues that the jury's finding of material breach  
13 defeats any contention that the exclusive use provision was an  
14 independent covenant, referring to the statement in Section 4.5  
15 that "[t]he obligations of Tenant in this Lease shall be separate  
16 and independent covenants and agreements." Flagship contends  
17 that, if Excel believed that Section 4.5 made Excel's obligation  
18 to honor the exclusive use provision an independent covenant,  
19 thereby making the breach of the exclusive use provision not  
20 material, Excel should have presented this contention to the  
21 jury. Flagship asserts: "Because Defendants did not do so, and  
22 the jury decided the question of materiality, they cannot now ask  
23 the court to decide this question."

24 Flagship cites *Gaia Technologies, Inc. v. Recycled Products,*  
25 *Corp.*, 175 F.3d 365 (5<sup>th</sup> Cir.1999). In *Gaia*, the alleged owner  
26 of patents and trademarks brought an action against corporate and

1 individual defendants for infringement under federal law, and for  
2 unfair competition, tortious interference with prospective  
3 contractual relations, and misappropriation of trade secrets  
4 under state law. After the alleged owner obtained judgment  
5 against defendants, the Federal Circuit reversed as to the  
6 infringement claims and remanded, allowing the District Court to  
7 decide whether to exercise supplemental jurisdiction over the  
8 state law claims. On remand, the District Court entered judgment  
9 for the alleged owner on the state law claims and the individual  
10 defendants appealed to the Fifth Circuit. The Fifth Circuit held  
11 that the District Court erred in relying on Rule 49(a), Federal  
12 Rules of Civil Procedure, to make findings contrary to the jury's  
13 verdict:

14           Nothing in the text of Rule 49(a) authorizes  
15           a district court to reform a jury's decision  
16           on issues submitted to the jury. Rule 49(a)  
17           allows the district court to make its own  
18           findings only as to issues not submitted to  
19           the jury ... Furthermore, Rule 49(a) does not  
20           permit a district court to make findings  
21           contrary to the jury verdict. See *Askanase*,  
22           130 F.3d at 670 ('Appellant correctly states  
23           that a Rule 49(a) finding cannot be  
24           inconsistent with the jury verdict.');

25           also *Floyd v. Laws*, 929 F.2d 1390, 1397 (9<sup>th</sup>  
26           Cir.1991) (holding that 'under Rule 49(a), the  
          trial court simply cannot choose to ignore a  
          legitimate finding that is part of the  
          special verdict'). Here, the district court  
          submitted the elements of Gaia's state law  
          claims to the jury, and the jury found that  
          Gaia failed to prove any of the elements as  
          to the individual defendants. Thus Rule  
          49(a) does not authorize the district court  
          to reform the jury's state law findings in  
          order to hold the individual defendant's  
          liable for Gaia's state law causes of action.

1 *Id.* at 370-371.

2       Flagship notes that, although Flagship argued that the  
3 verdict was a special verdict, the Court ruled that the verdict  
4 was a general verdict. (Doc. 353, November 19, 2004 Memorandum  
5 Decision, 29:6-7). Flagship contends that the "rule articulated  
6 in *Gaia*" is not tied to any particular form of verdict:

7             Preliminarily, the individual defendants  
8 contend that we should treat the jury verdict  
9 as a general verdict accompanied by  
10 interrogatories, governed by Rule 49(b), as  
11 opposed to a special verdict, governed by  
12 Rule 49(a) ... According to the defendants,  
13 Rule 49(b) affords greater deference to a  
14 jury's finding than Rule 49(a). We need not  
15 address this contention, however, because we  
16 conclude that not even Rule 49(a) authorizes  
17 the district court's modification of the jury  
18 verdict. *Gaia* does not contend that Rule  
19 49(b) provides an alternative ground for  
20 upholding the district court's reformation.

21 *Gaia, supra*, 175 F.3d at 370 n.5. Because, Flagship argues, the  
22 type of verdict does not affect the "validity of this rule," and  
23 "because the jury decided that the exclusive use provision, and  
24 Defendants' breach thereof was material, Defendants cannot now  
25 ask the court to make a ruling contrary to the jury's verdict."

26       Excel responds that the jury's verdict is irrelevant to  
interpretation of the Ground Lease, an issue of law for the  
Court. However, as ruled *supra*, Excel's construction of Section  
4.5 is without merit.

      Excel further asserts that, in an action at law for breach  
of contract, a material breach generally entitles the non-  
breaching party to cancel a contract prospectively and recover

1 damages, but does not, as a matter of course justify rescission.  
2 Excel contends that Flagship cites no authority allowing  
3 rescission for breach of an independent covenant:

4           They simply assert that the jury's finding of  
5           a 'material breach' in the breach of contract  
6           action trumps the Ground Lease and converts  
7           its independent covenants into conditions  
8           precedent. This is unsustainable as a matter  
9           of the law of independent covenants and,  
10          therefore, the finding of material breach is  
11          irrelevant to the issues now before the  
12          Court.

13 Excel argues that, if the jury had found the exclusive use  
14 provision to be a dependent covenant, such a verdict would have  
15 been vacated by the Court under Rule 50, Federal Rules of Civil  
16 Procedure, as not supported by the evidence. For the reasons  
17 stated *supra*, Excel's contention is baseless, if not vexatious.  
18 A jury does not make a legal finding whether a covenant is  
19 dependent.

20           Excel cites *Barerra v. State Farm Mut. Auto. Ins. Co.*, 71  
21 Cal.2d 659 (1969). In *Barrera*, the plaintiff sued State Farm to  
22 compel payment of a judgment against State Farm's insureds, the  
23 Alves, for their negligent driving that injured the plaintiff.  
24 Plaintiff alleged the enforceability at the time of the accident  
25 of State Farm's liability policy. State Farm denied the validity  
26 of the policy, and cross-claimed seeking a declaration that the  
policy was void *ab initio* because it was issued in reliance on a  
material misrepresentation by the Alves. Plaintiff contended  
that State Farm was estopped to rescind the policy six months  
after the accident because State Farm led the Alves to believe

1 that he was insured and because State Farm negligently failed to  
2 discover within a reasonable time the misrepresentation in the  
3 application tendered more than a year prior to the accident. The  
4 trial court found that State Farm issued the policy in reliance  
5 on a material misrepresentation, that rescission was therefore  
6 justified, and that State Farm acted promptly upon discovery of  
7 the misrepresentation, and found for State Farm. Plaintiff moved  
8 for a new trial on the ground that the public policy expressed in  
9 California's Financial Responsibility Law impelled a finding of  
10 laches by State Farm in its belated discovery of the  
11 misrepresentation and that its failure to act promptly worked to  
12 the detriment of an innocent member of the public, who should  
13 therefore recover against State Farm. The trial court denied the  
14 motion for new trial. On appeal, the Supreme Court reversed for  
15 a new trial, ruling that an automobile liability insurer must  
16 undertake a reasonable investigation of the insured's  
17 insurability within a reasonable period of time from the  
18 acceptance of the application and issuance of the policy; that  
19 this duty inures directly to the benefit of third persons injured  
20 by the insured; that the injured party, who has obtained an  
21 unsatisfied judgment against the insured, may proceed against the  
22 insurer; and that the insurer cannot then successfully defend  
23 upon the ground of its own failure reasonably to investigate the  
24 application. 71 Cal.2d at 663. The Supreme Court noted:

25 In addition to arguing that State Farm was  
26 estopped to rescind the policy because of  
negligent failure to discover the

1 misrepresentation within a reasonable time,  
2 plaintiff also argued that section 651 of the  
3 Insurance Code applied to rescission as well  
4 as to prospective cancellation of automobile  
5 insurance policies, and that therefore the  
6 attempted rescission did not take effect  
7 until 10 days after notice of rescission was  
8 sent to Mr. Alves. If termination of the  
9 policy did not occur until after notice, the  
10 policy remained in effect at the time of the  
11 accident.

12 Plaintiff's contention regarding section 651  
13 runs counter to the statutory scheme for  
14 termination of insurance contracts and blurs  
15 the clear statutory distinction between  
16 'rescission' (retroactive termination) and  
17 'cancellation' (prospective termination) of  
18 insurance policies. Section 651 provides:  
19 'Notwithstanding any other provision of this  
20 code, no cancellation by an insurer of an  
21 auto liability insurance policy shall be  
22 effective prior to the mailing or delivery to  
23 the named insured at the address shown in the  
24 policy, of a written notice of cancellation  
25 stating when, not less than ten (10) days  
26 after the date of such mailing or delivery,  
the date the cancellation shall become  
effective.'

1 The Legislature added section 651 in 1957 ...  
2 In 1957, the Insurance Code did not contain a  
3 separate chapter on 'Cancellation' ....

4 The statutory scheme reflects a deliberate  
5 distinction between 'rescission' and  
6 'cancellation.' Sections 331, 338, and 359,  
7 which prescribe the grounds for rescission,  
8 all involve false statements or material  
9 omissions in the procurement of the policy.  
10 Section 660 ..., on the other hand, provided:  
11 'The commissioner, by regulation, shall  
12 prescribe the grounds upon which an insurer  
13 may cancel a policy of automobile insurance.  
14 No insurer shall cancel a policy of  
15 automobile insurance except upon such ground  
16 or grounds as have been prescribed by the  
17 commissioner.' ....

18 Unless we say that automobile liability  
19 insurance policies cannot be rescinded at all

1 and that section 660 completely abrogated the  
2 rescission section for automobile liability  
3 insurance, we must hold that section 651,  
4 which specifically refers to 'cancellation,'  
5 does not control the procedure for  
6 'rescission' of automobile liability  
7 insurance. Instead, the general section  
8 governing rescission of insurance policies,  
9 section 650, applies. Section 650 provides:  
10 'Whenever a right to rescind a contract of  
11 insurance is given to the insurer by any  
12 provision of this part such right may be  
exercised at any time previous to the  
commencement of an action on the contract.'  
The issue, then, turns on the validity of  
plaintiff's contention that the public policy  
of this state requires that an automobile  
liability insurer reasonably investigate  
within a reasonable time after issuance of  
the policy or otherwise be estopped to  
rescind the policy, at least in an action by  
an injured person who has obtained a judgment  
from the insured.

13 71 Cal.2d at 663 n.3.

14 Excel also cites *Mamula v. McCulloch*, 275 Cal.App.2d 184,  
15 196-197 (1969):

16 Plaintiff urges that the court erred in  
17 failing to make findings upon the issue as to  
18 whether or not she was entitled to recover on  
the theory of unjust enrichment.

19 The trial court found that the oral agreement  
20 of July 1, 1963, was for the abandonment and  
21 cancellation of the oral purchase and sale  
22 agreement involving the hospital property and  
23 that it was supported by a valuable  
24 consideration. As heretofore pointed out,  
25 such oral agreement made a complete  
26 disposition of the rights of the respective  
parties under the oral purchase and sale  
agreement. Such rights having been  
completely settled by the oral contract of  
abandonment, there was no basis for the  
application of the rule of unjust enrichment.

'To "cancel" a contract means to abrogate so  
much of it as remains unperformed. It

1 differs from "rescission," which means to  
2 restore the parties to their former position.  
3 The one refers to the state of things at the  
4 time of cancellation; the other to the state  
5 of things existing when the contract was  
6 made.' ... Here, the oral agreement of  
7 cancellation did away with the oral agreement  
8 of purchase and sale upon the terms and  
9 conditions and with the consequences  
10 mentioned in the agreement of cancellation  
11 ... In this state of the record, a specific  
12 finding on whether plaintiff was or was not  
13 entitled to recover on the theory of unjust  
14 enrichment would be redundant.

15 Excel cites *Fireman's Fund American Ins. Co. v. Escobedo*, 80  
16 Cal.App.3d 610 (1978), which involved an action by the insurance  
17 company of one motorist against the insurance company of the  
18 second motorist and the motorists. The trial court determined  
19 that defendant insurer's rescission of its insureds' assigned  
20 risk automobile policy was effective as against its insureds, but  
21 ineffective as against the owners and drivers of the other  
22 vehicle and plaintiff, their insurer. On appeal, the Court of  
23 Appeals addressed the argument that once a risk has been assigned  
24 under the California Automobile Assigned Risk Plan (CAARP) and  
25 the designated insurer has ratified the coverage, 10 California  
26 Administrative Code § 2470, specifies the only method open to an  
insurer to relieve itself of an assigned risk which was accepted:

27 Section 331 of the Insurance Code provides:  
28 'Concealment, whether intentional or  
29 unintentional, entitles the injured party to  
30 rescind insurance.' Concealment is defined  
31 as 'Neglect to communicate that which a party  
32 knows, and ought to communicate ....' ... In  
33 addition to concealment as a ground for  
34 rescission, section 359 of the Insurance Code  
35 provides that a contract of insurance may be  
36 rescinded on the ground of material

1 misrepresentation: 'If a representation is  
2 false in a material point, whether  
3 affirmative or promissory, the injured party  
is entitled to rescind the contract from the  
time the representation becomes false.' ....

4 The California Assigned Risk Plan was enacted  
5 to provide liability insurance coverage for  
6 applicants who are *in good faith* entitled to  
but unable to procure such insurance through  
7 ordinary methods ... Nothing in the  
8 authorizing legislation suggests that the  
9 laws applying to insurance policies in  
10 general are not applicable to the assigned  
11 risk plan. The regulations promulgated by  
12 CAARP deal only with cancellation and not  
rescission. Cancellation and rescission are  
not synonymous. One is prospective, while  
the other is retroactive ... Appellant  
Employer's Casualty is correct in its  
contention that the statutory remedy of  
rescission is applicable to assigned risk  
policies.

13 80 Cal.App.3d at 619.

14 Excel also cites *Welles v. Turner Entertainment Co., supra*,  
15 503 F.3d 728.<sup>4</sup> In *Welles*, the plaintiff argued that the Exit  
16 Agreement, which "cancelled and terminated" the Production  
17 Agreement, returned the *Citizen Kane* copyright to Mercury. The  
18 Ninth Circuit ruled:

19 [T]he Exit Agreement stated that it was 'the  
20 mutual desire of the parties to terminate and  
cancel' their prior agreements. Beatrice  
21 Welles argues that this language rescinded  
the parties' prior agreements and thus  
22 returned any right Orson Welles and Mercury  
had in the *Citizen Kane* motion picture to  
23 them. However, under California law, it  
seems that 'terminate' and 'cancel' mean  
24 something different from 'rescind':

---

25 <sup>4</sup>Excel cited *Welles* as *Welles v. Turner Entertainment Co.*, 488  
26 F.3d 1178 (9<sup>th</sup> Cir.2007). However, the opinion was amended and  
superseded on denial of rehearing.

1           The words 'terminate,' 'revoke' and  
2           cancel,' ... all have the same  
3           meaning, namely, the abrogation of  
4           so much of the contract as might  
5           remain executory at the time notice  
6           is given, and must be sharply  
7           distinguished from the word  
8           'rescind,' ... which conveys a  
9           retroactive effect, meaning to  
10          restore the parties to their former  
11          position.

12           *Grant v. Aerodraulics Co.*, 91 Cal.App.2d 68  
13          ... (1949). Thus, under California law, the  
14          Exit Agreement prospectively terminated and  
15          cancelled Orson Welle's right to royalties,  
16          but did not retroactively rescind RKO's  
17          copyright in the *Citizen Kane* motion picture  
18          unless RKO's copyright remained executory at  
19          the time of the Exit Agreement.

20          503 F.3d at 738.

21           Excel asserts that the jury was not instructed on rescission  
22          or failure of consideration, but was instructed only on  
23          prospective cancellation in connection with Flagship's breach of  
24          contract claim. This, of course, was a result of the parties'  
25          express agreement that the issue of rescission was to be  
26          determined after the jury's verdict. Excel refers to the Court's  
27          statement to the jury on December 2, 2003 (Exh. E to Excel's  
28          response to Flagship's motion regarding interpretation of Section  
29          4.5) :

30           defendant was - and I'm using the word Excel  
31          Realty Partners, that's one of the defendants  
32          - was canceled.

33           A party to a contract may cancel the contract  
34          if, for any reason, the party does not  
35          receive the material performance that was  
36          promised by the other party or if an  
37          important part of the performance that was  
38          promised was not provided.

1           The term 'material,' as used in the  
2           instructions, means important or serious.  
3           You must decide whether plaintiff failed to  
4           receive any material performance defendant  
5           promised to provide. Performance is material  
6           if it is important to a contract and if it is  
7           likely to cause a reasonable person not to  
8           have entered into the contract if such  
9           performance was not provided.

10          Thus, Excel contends, the jury was never instructed on rescission  
11          and never asked to determine whether there was a failure of  
12          consideration (or whether the breach was so material that it  
13          would constitute a failure of consideration). Based on *Welles*,  
14          Excel contends:

15                 [T]he jury verdict of material breach in no  
16                 way constituted a finding of a failure of  
17                 consideration or of a right to rescission.  
18                 And, the jury's verdict cannot overrule a  
19                 fundamental principle of contract, that  
20                 breach of an independent covenant does not  
21                 justify rescission.

22          Flagship replies that the cases upon which Excel relies in  
23          distinguishing between "cancel" and "rescind" concern  
24          interpretation of insurance policy language under very specific  
25          provisions of the California Insurance Code or the construction  
26          of a second agreement that purported to "cancel" a prior  
27          agreement. This is true. The insurance contract cases are  
28          inapplicable. Flagship cites *Pico Citizens Bank v. Tafco, Inc.*,  
29          201 Cal.App.2d 131 (1962).

30          In *Pico Citizens Bank*, Moos and Tafco entered into a written  
31          contract by which Moos agreed to manufacture and Tafco agreed to  
32          sell knife and scissor sharpeners. In a letter signed by Tafco's  
33          president, various oral agreements theretofore reached were

1 confirmed; among other things, the agreement provided that title  
2 to the sharpeners would remain in Moos until they were sold by  
3 Tafco to third parties. Another clause of the contract provided:  
4 "In the event it [the contract] is cancelled by either party, the  
5 above arrangement will remain in effect until you [seller] have  
6 been paid for the merchandise delivered and the dies and other  
7 equipment of ours returned to us. Neither party shall terminate  
8 any part of this agreement without giving the party ninety (90)  
9 days written notice in advance." The appellate court held:

10 Taking up the first of Tafco's major points  
11 on appeal, it is contended that neither the  
12 letter of May 10, 1955, nor the notice of  
13 rescission received by Tafco on June 24,  
14 1955, served to cancel the contract within  
15 the meaning of the subject agreement.  
16 Emphasized by Tafco is the claim that the  
17 word 'cancel' is not found in either  
18 document. Thus, the May 10 letter simply  
19 demanded an accounting and payment in full of  
20 the outstanding balance, while the June  
21 notice and demand made use of the word  
22 'rescission' in its heading. There is a  
23 distinction, of course, between the terms  
24 'cancel' and 'rescind' - accordingly, it has  
25 been observed that 'an important problem of  
26 construction is presented by notices or  
agreements which purport to terminate the  
contract.' (Witkin, Summary of Cal. Law (7<sup>th</sup>  
ed. 1960) 324). Cited in the work just  
quoted is *Winter v. Kitto*, 100 Cal.App. 302  
..., wherein expressions of 'cancellation' or  
'rescission' were not construed as the  
renunciation of any claim for damages for  
prior breach unless such intention clearly  
appears. The factual question is a close  
one; but two trials have resulted in findings  
that either or both of the documents just  
mentioned effected a cancellation pursuant to  
the terms of the agreement. 'The question of  
whether a contract has been cancelled,  
rescinded or abandoned is a mixed question of  
law and fact ... which is addressed to the

1 trial court ... and the finding of the trial  
2 court will be upheld if it is supported by  
substantial evidence.' ....

3 Relying on this statement from *Pico Citizens Bank* and their  
4 asserted distinction of the cases relied upon by Excel, Flagship  
5 asserts:

6 As such, the difference between cancellation  
7 and rescission is material to construing a  
8 second agreement or writing and whether it  
9 purports to cancel the remainder of a  
contract that is executory, or whether it  
10 seeks to rescind the contract ... Here, Excel  
11 does not raise any issue that Flagship's  
notice of rescission, which was presented to  
12 the jury, sought anything other than  
rescission. Overall, Defendants do not  
13 explain how these cases advance their  
14 proffered interpretation of the Lease.

15 What can be said about the jury's verdict is that it  
16 determined there was a breach of contract and that the breach was  
17 material, giving rise to Flagship's election of remedies.

18 9. Equitable Estoppel.

19 Although conceding that judicial estoppel may not apply to  
20 the facts, Flagship asserts that the Court did not decide whether  
21 equitable estoppel applied. Flagship refers to the September 30  
22 Memorandum Decision, (Doc. 362, 18:23-19:):

23 Defendant also argues that the court erred in  
24 holding that equitable estoppel barred  
25 Defendant from asserting § 4.5 as a defense.  
26 While it is true that the court cited  
elements of equitable estoppel in the  
estoppel section of its decision, it is not  
the case that the court actually held that  
equitable estoppel applied. A careful  
reading of the estoppel discussion reveals  
that the court's reasoning followed the law  
of judicial estoppel. At the end of the  
section, the court stated that '[b]y staying

1        silent on § 4.5 until the 9<sup>th</sup> day of trial  
2        and leading the court and Plaintiffs to  
3        believe that rescission was being actively  
4        litigated, Defendants are estopped from  
5        raising § 4.5 as a bar to a rescission  
6        remedy.' (Doc. 353, November 2004 Order 53)  
7        The court's discussion of the equitable  
8        estoppel standard and the absence of specific  
9        reference to judicial estoppel, even if  
10        ambiguous, does not prevent the application  
11        of judicial estoppel. This holding requiring  
12        Defendant to be bound by its conduct  
13        throughout the litigation is not clearly  
14        erroneous. Defendant was properly estopped  
15        from asserting § 4.5 as a bar to rescission.

16        Four elements must ordinarily be proved to establish an  
17        equitable estoppel: (1) the party to be estopped must know the  
18        facts; (2) he must intend that his conduct shall be acted upon,  
19        or must so act that the party asserting the estoppel had the  
20        right to believe that it was so intended; (3) the party asserting  
21        the estoppel must be ignorant of the true state of facts; and (4)  
22        he must rely upon the conduct to his injury. *Salgado-Diaz v.*  
23        *Ashcroft*, 395 F.3d 1158, 1166 (9<sup>th</sup> Cir.2005); *Hampton v.*  
24        *Paramount Pictures Corp.*, 270 F.3d 100, 104 (9<sup>th</sup> Cir.1960).

25        Flagship argues that these elements are satisfied:

26        Defendants allowed this case to proceed from  
27        the complaint through discovery, through  
28        trial without ever suggesting that  
29        Plaintiffs' were barred from their clearly  
30        pled claim for rescission. Defendants acted  
31        such that Plaintiffs had the right to believe  
32        the Lease did not prevent rescission, and  
33        that Defendants would assert this position.  
34        Plaintiffs had no idea Defendants would claim  
35        a provision listed in the Lease paragraph  
36        concerning rent and not expressly mentioning  
37        the word rescission barred the remedy of  
38        rescission. Plaintiffs reliance on  
39        Defendants' position is only strengthened by  
40        Defendants complete failure to raise the

1 issue in their answers, discovery responses,  
2 summary judgment proceedings, in motions *in*  
3 *limine*, pretrial statements, or pretrial  
4 conferences. As this Court has recognized,  
5 Plaintiffs relied on Defendants' failure to  
6 assert Section 4.5 as a bar to rescission,  
7 and therefore were prejudiced by not having  
8 the opportunity to conduct discovery as to  
9 the 'commercial setting, purpose, and effect'  
10 of Section 4.5. (Doc. No. 362 at 18:10-22).

11 In the September 30 Memorandum Decision, the Court, in its  
12 discussion of application of judicial estoppel, ruled:

13 Third, Defendant would obtain an unfair  
14 advantage if it is allowed to assert § 4.5 as  
15 a bar to rescission at such a late stage in  
16 the litigation. Discovery was not conducted  
17 as to § 4.5. Plaintiffs did not know the  
18 section would be invoked as a defense by any  
19 dispositive motion or the Pretrial Order.  
20 The contract damages awarded by the jury that  
21 Defendant would have to pay amount to  
22 approximately \$1.5 million; the damages that  
23 Defendant could potentially pay if rescission  
24 is granted are substantially more, up to the  
25 [sic] approximately \$3.9 million. Finally,  
26 estoppel in this situation serves the overall  
policy goal of judicial estoppel to 'protect  
against a litigant playing fast and loose  
with the courts.' ....

(Doc. No. 362 at 18:10-22).

Excel responds that Flagship's argument concerning  
application of equitable estoppel is "utterly spurious." Excel  
refers to the November 19, 2004 Memorandum Decision, (Doc. 353),  
where the Court discussed whether Excel waived application of  
Section 4.5 as a contractual limitation on the recovery available  
to Flagship. (Doc. 353, 37:12-54:5). Specifically, Excel  
refers to the following conclusion in the November 19, 2004  
Memorandum Decision:

1 With respect to contractual limitations on  
2 damages in a contract dispute, the defense is  
3 contained in the cause of action itself.  
4 Both sides had full access to the Lease (38  
5 pages long) and are presumed to have examined  
6 it carefully. There is no danger of unfair  
7 surprise by assertion of this defense.

8 (Doc. 353, 41:22-26). Excel contends that Flagship was not  
9 ignorant of the true facts:

10 Excel is unaware of any basis or any judicial  
11 precedent applying equitable estoppel to a  
12 party's assertion of its rights under a  
13 written contract, the provisions of which  
14 were specifically negotiated and executed by  
15 the parties and Plaintiffs have cited no such  
16 authority. This is not a case of a hidden  
17 unknown fact being secreted by one party to  
18 disadvantage another.

19 Flagship replies that Excel mischaracterizes Flagship's  
20 asserted basis for equitable estoppel:

21 Defendants never asserted their  
22 interpretation that Section 4.5 bars  
23 rescission until over two years after  
24 Plaintiff's notice of rescission, and until  
25 after a 9-day trial litigating the very  
26 remedy they claim Section 4.5 bars. (See  
27 Pltfs' P&A at 19-23.) If Defendants believed  
28 Section 4.5 meant what they now claim it  
29 does, it was incumbent on them to assert the  
30 bar to rescission upon receipt of Plaintiffs'  
31 notice of rescission, in their answer,  
32 discovery responses, summary judgment  
33 motions, trial brief, or motions in limine.  
34 Instead, Defendants allowed the entire case  
35 to proceed, even acquiescing that rescission  
36 was an available remedy at the pretrial  
37 conference (See Pltfs' ER, Ex. J at 18),  
38 without mentioning that any provision of the  
39 Lease, in their view, barred rescission. A  
40 clearer case for equitable estoppel could not  
41 be made.

42 Flagship's reference is to the hearing on motions in limine  
43 conducted on October 31, 2003, where the Court inquired "whether

1 anybody wants the jury to be making any findings on the  
2 rescission." Mr. Fairbrook indicated that Flagship wished  
3 issues of contested fact as to equitable matters submitted to the  
4 jury. Mr. Carroll stated:

5 The defense perspective is that there's two  
6 issues really. One is we believe the  
7 plaintiffs have taken the position that  
8 mistake is no longer an issue in this case,  
9 both in conjunction with the pretrial  
10 statement and in the opposition of motions  
11 for summary judgment.

12 The only grounds for rescission left in the  
13 case at this point is a failure for  
14 consideration. That's the position we take,  
15 that's what's been represented, that's the  
16 position we understood to be the case at this  
17 juncture.

18 (Doc. 502, Exh. J).

19 There is no question that Excel failed to assert that  
20 Section 4.5 precluded the remedy of rescission until after the  
21 trial in this action and that Excel's delay in asserting its  
22 interpretation of Section 4.5 caused undue attorney and judicial  
23 time in post-trial proceedings involving Flagship's election of  
24 the rescission remedy. Excel's contention that Flagship was  
25 always aware that Section 4.5 barred rescission by Flagship of  
26 the lease because of Excel's breach of the exclusive use  
provision is not supported by the record in this action and  
Excel's belated assertion of its position precluded Flagship from  
conducting discovery concerning Excel's interpretation of Section  
4.5 or seeking summary judgment as to the construction of Section  
4.5 in the context of extrinsic evidence. The position was also

1 unknown to the Court. The Section 4.5 bar theory was not  
2 asserted in pleadings, it was not specifically disclosed in the  
3 Pretrial Order, nor was it the subject of any discussion in a  
4 trial brief or in jury instruction input.

5 10. Arguments Raised by Excel in Opposition to  
6 Flagship's Motion.

7 In opposing Flagship's motion, Excel asserts that rescission  
8 is barred because Plaintiffs, by their conduct, affirmed the  
9 Ground Lease after they asserted that Excel breached it, and  
10 because Plaintiffs failed to proffer the written consent of the  
11 Money Store to extinguish the estate created by the Ground Lease  
12 as required by Section 22.4. It is in connection with this  
13 latter contention that Excel's motion to strike and/or for leave  
14 to file a sur-reply brief is directed. In addition, Flagship  
15 contends that Excel attacks the jury instructions with respect to  
16 rescission.

17 a. Outside the Ninth Circuit's Mandate.

18 Flagship argues that these contentions are outside the  
19 mandate of the Ninth Circuit, e.g., to "determine in the first  
20 instance whether the contract, in its entirety, allows for  
21 rescission and whether California law would give effect to the  
22 lease's limitations on remedies in these circumstances."

23 As explained in *Kearns v. Field*, 453 F.2d 349, 350 (9<sup>th</sup>  
24 Cir.1972):

25 The mandate is controlling as to all matters  
26 within its compass ...; however, any issue  
not expressly or impliedly disposed of on

1           appeal may be considered by the trial court  
2           on remand.

3           Flagship's contention raises the question whether the Ninth  
4           Circuit's remand is a "limited remand" or a "general remand."  
5           The term "limited remand" describes a remand to the district  
6           court for proceedings prior to the Ninth Circuit's consideration  
7           of the merits of an appeal. See *United States v. Washington*, 172  
8           F.3d 1116, 1118 (9<sup>th</sup> Cir.1999), citing *Mirchandani v. United*  
9           *States*, 836 F.2d 1223, 1225 (9<sup>th</sup> Cir.1988). Once an appeal has  
10          been decided on the merits, the mandate is issued; if the case is  
11          remanded for further proceedings, the trial court must proceed in  
12          accordance with the mandate and the law of the case as  
13          established on appeal. *Id.*, citing *Stevens v. F/V Bonnie Doon*,  
14          731 F.2d 1433, 1435 (9<sup>th</sup> Cir.1984). The mandate "'is controlling  
15          as to all matters within its compass, but leaves the district  
16          court any issue not expressly or impliedly disposed of on  
17          appeal.'" *Id.*

18          In contending that the issues raised by Excel are outside  
19          the mandate, Flagship asserts that it is clear that the Ninth  
20          Circuit specifically directed the Court to decide whether Section  
21          4.5 of the Lease, as construed in its entirety, is a bar to  
22          rescission. Flagship argues:

23                 While the court expressly left open the  
24                 question of rescission damages, the mandate  
25                 did not set the case at large. Importantly,  
26                 the court of appeal did not disturb the  
                jury's verdict. Most significantly in this  
                regard, Excel on appeal attacked the jury  
                verdict in two respects: arguing that the  
                jury was not instructed on rescission, and

1           that the evidence was insufficient to support  
2           a finding of material breach, necessary to  
3           support rescission ... In issuing a limited  
4           mandate that the district court must decide  
5           whether Section 4.5 of the Lease bars the  
6           remedy of rescission, the court of appeal  
7           impliedly rejected these arguments. In this  
8           regard, it would make little sense to remand  
9           the case to the district court to determine  
10          if rescission could be elected by Plaintiffs  
11          if the jury's finding of a material breach  
12          was not supported by the evidence as Excel  
13          contended on appeal. Accordingly, implied  
14          within the court of appeal's mandate is a  
15          rejection of Defendants' claims of  
16          instructional error and sufficiency of the  
17          evidence.

18          Flagship's contention is without merit. The Ninth Circuit's  
19          remand is broad enough to permit the Court to consider whether  
20          rescission, if permissible under the terms of the lease, is  
21          nonetheless barred under California law because of Flagship's  
22          conduct after notice of rescission was given.

23                   b. Rescission Barred by Flagship's Conduct.

24          Excel argues that rescission is barred because Flagship  
25          affirmed the Lease after asserting that Excel had breached it.

26          Excel cites 1 Witkin, *Summary of California Law, Contracts*,  
§ 886: "The injured party may lose his right to rescind by ...  
conduct (such as retention of benefits) indicating an election to  
affirm the contract." Excel further cites *Neet v. Holmes*, 25  
Cal.2d 447, 457-458 (1944):

          The general rule, with certain exceptions not  
applicable to the facts involved in the case,  
is that the offer to restore what has been  
received under the contract is a condition  
precedent to maintaining an action founded on  
the assumption that rescission has been  
accomplished by the act of the party ... The

1 right to rescind may be waived ... It is  
2 waived by recognition of the existence of the  
3 contract after the right to rescind was  
4 created ... Waiver of a right to rescind will  
5 be presumed against a party who, having full  
6 knowledge of the circumstances which would  
7 warrant him in rescinding, nevertheless  
8 accepts and retains benefits accruing to him  
9 under the contract ... It has been said that  
10 citation of authorities is unnecessary in  
11 support of the doctrine well established in  
12 this state that an affirmance of the contract  
13 at a time subsequent to the discovery of the  
14 falsity of the representations inducing its  
15 execution forecloses the exercise of the  
16 right of rescission.

17  
18 Excel argues that Flagship affirmed the Lease by entering  
19 into two Forebearance Agreements with The Money Store in October  
20 2001 and October 2002, respectively. (Excel's Response, Exhs. B  
21 and C). The Forebearance Agreements each provide that Flagship  
22 "shall continue to make monthly lease payments to Excel Realty  
23 Partners." The Forebearance Agreements provide:

24  
25 It is expressly understood that the failure  
26 to make payments or meet any term as  
referenced in this Agreement will constitute  
a default of the Forebearance Agreement and  
[TMS] will then be free to exercise any and  
all rights consistent with the Stockton Loan  
and the Modesto Loan agreements.

27  
28 Excel asserts that Flagship voluntarily entered into the  
29 Forebearance Agreements with full knowledge of their terms and  
30 agreed to dismiss The Money Store from this lawsuit in exchange  
31 for Flagship's covenant to keep the Lease in full force and  
32 effect. Excel refers to a partial transcript of the Rule 50  
33 motions during the jury trial on November 26, 2003:

34  
35 And I don't know - my tentative ruling is I  
36 don't see this as a constructive eviction

1 case.

2 MR. FAIRBROOK: Okay.

3 THE COURT: So I will read those cases and I  
4 will give it some thought, but that's the way  
I see it.

5 MR. FAIRBROOK: Let me underscore one point  
6 for you. I think the critical factor is, and  
7 the evidence is this, that we closed the  
restaurant, the equipment was removed, and it  
remained vacant but for the attempts -

8 THE COURT: I know that, but you are charged  
9 with knowledge of the law and the fact that  
- and there are good reasons, you know, not  
10 to have sued, but you could have sued the  
11 lender for putting you in this position and  
12 for not backing you a hundred percent, and  
13 you chose to compromise with that lender  
14 because they have got the gun at your head  
15 and they are saying, in other words,  
16 'Mitigate, try to find a new tenant, keep  
17 paying the rent, don't just use the real  
18 property remedies here and the contract  
19 remedies, but primarily the real property,  
20 which says when you are constructively  
21 evicted, you have got to go, you have got to  
22 get out and give back the keys.'

23 ...

24 MR. FAIRBROOK: When they talk about those,  
25 they talk about the benefit that the tenant  
26 receives by remaining in possession and  
hedging his bets on whether he is going to  
overcome it and none of those, none of those  
things exist here. And that's why I think  
those cases -

27 THE COURT: I know that. And - but what the  
28 law says, and you are not in the strong  
29 bargaining position where you are in default  
30 on a \$2 million loan, quite frankly, and the  
31 lender is willing to do anything, except  
32 basically cut you off.

33 So the bottom line is that, unfortunately,  
34 counsel for the lender wasn't willing to  
35 recognize that your optimum condition was to

1 return the keys and get as far away from that  
2 site as you possibly could.

3 (Excel's Response, Exh. D).

4 Excel further refers to evidence that Flagship retained a  
5 real estate agent from April 2001 through the trial to market the  
6 Premises for sale or sublease and that, in 2001, Flagship had a  
7 specific buyer and conducted negotiations with The Money Store,  
8 Excel, and the potential buyer to sell the Lease and the  
9 Premises. (Excel's Response, Exh. B). Excel asserts in a  
10 footnote:

11 After this proposed sale fell through,  
12 Plaintiffs destroyed the *status quo ante* by  
13 agreeing to a distress sale of the Golden  
14 Corral's restaurant equipment, in which  
equipment that Plaintiffs claim 'cost'  
\$600,000 was disposed of for \$11,000.00.  
Here again, Plaintiffs acted in a manner  
wholly inconsistent with rescission.

15 Excel contends that, in October 2003, on the eve of trial,  
16 Flagship sublet the Premises for a Halloween costume store. All  
17 of this conduct, Excel argues, demonstrates that Flagship waived  
18 the right to rescind the Lease by its conduct:

19 Here, Plaintiffs not only continued to treat  
20 the Ground Lease as binding by paying rent  
21 and subletting the premises, but they also  
22 held out the Ground Lease as binding to third  
parties, when they attempted to sell it and  
the restaurant business.

23 However, as Flagship notes, Excel expressly confirmed during  
24 the trial that Flagship's continued payment of rent was not a  
25 basis for waiver of the right to rescind:

26 MR. CARROLL: Your Honor, I don't believe  
there has been any claim made that - because

1 of relevance, that the payment of any of the  
2 lease payments was in any way a defense in  
this case.

3 THE COURT: I understand there to be a claim  
4 for the lease payments because there is a  
claim for rescission as of the date of notice  
5 of termination of the lease and, therefore,  
this is relevant evidence because they are  
6 continuing to pay under protest because they  
were required by the lender.

7 MR. CARROLL: We are not contending in this  
8 case that continued payment in any way is a  
defense for or impairs their ability to  
rescind.

9 THE COURT: It's an element of damage that is  
10 sought to be recovered.

11 MR. CARROLL: But this letter isn't an element  
12 of damages. The check is, your Honor.

13 MR. WASHBURN: There are claims of waiver and  
estoppel.

14 THE COURT: So long as waiver and estoppel is  
15 claimed.

16 MR. CARROLL: Not on the defense of any  
payments. It has never been in this case.

17 THE COURT: What we will do is this. On that  
18 condition, that there be no argument to the  
jury and there be no suggestion that the  
19 continued payment of rent under protest would  
be a waiver of [sic] estoppel, which would be  
20 a waiver of any kind of defense. We will  
keep the letter out, but we have already got  
21 the witness' testimony about how long they  
continued to make these rent payments. [¶]  
22 You may ask your next question.

23 (Excel's Motion, Exh. K, 590:17-591:21).

24 Flagship argues that Excel is now judicially estopped from  
25 asserting that Flagship's continued payment of rent waives  
26 rescission of the Lease. Determining whether judicial estoppel

1 should be invoked is informed by several factors: (1) whether a  
2 party adopts a position clearly inconsistent with its earlier  
3 position; (2) whether the court accepted the party's earlier  
4 position; and (3) whether the party would gain an unfair  
5 advantage or impose an unfair detriment on the opposing party if  
6 not estopped. *New Hampshire v. Maine*, 532 U.S. 742, 750-751  
7 (2001). In addition, Flagship argues that Excel's argument  
8 violates the Ninth Circuit's mandate:

9           The court of appeal's mandate and findings  
10          with respect to the defense of rescission and  
11          judicial estoppel are targeted at Defendants'  
12          attempt to defeat rescission on the basis of  
13          Section 4.5 of the Lease, not on the basis of  
14          Plaintiffs' conduct. To allow Defendants to  
15          raise the defense of waiver based on conduct  
16          at this stage would violate the court of  
17          appeal's mandate and would amount to  
18          reconsideration of the jury's verdict.

19          Flagship further argues that the continued payment of rent  
20          under protest on a premises Flagship had vacated and was deriving  
21          no benefit from, does not demonstrate affirmation of the Lease,  
22          citing *DRG/Beverly Hills, supra*, 30 Cal.App.4th at 59: "Waiver is  
23          the intentional relinquishment of a known right after full  
24          knowledge of the facts and depends upon the intention of one  
25          party only." Flagship contends:

26          Defendants offered nothing with respect to  
27          Plaintiffs' intent to negate the evidence of  
28          payment of rent under protest and the intent  
29          to rescind. The evidence was that Plaintiffs  
30          surrendered possession, but that Plaintiffs'  
31          surrender was refused by Defendants.  
32          Moreover, the evidence offered at trial was  
33          that after the close of Plaintiffs' business  
34          in April 2001, Plaintiffs never operated a  
35          restaurant there or enjoyed use of the

1 premises. Instead, due to Defendants'  
2 refusal to accept Plaintiffs' surrender as a  
3 means of mitigation, Plaintiffs entered into  
4 an agreement with the bank wherein Plaintiffs  
5 agreed to pay rent ... The evidence further  
6 offered by Plaintiffs demonstrated that with  
7 each rent payment made under protest, a  
8 protest letter was sent, thus indicating an  
9 affirmative intent *not to affirm the lease or*  
10 *accept its benefits*, a fact which Defendants  
11 conceded in order to keep the protest letters  
12 out of evidence ... In other words, the  
13 evidence in this case was that Plaintiffs'  
14 continued payment of rent under the  
15 forbearance agreements was done not in an  
16 attempt to do any fact inconsistent with the  
17 claim of rescission, but simply, as an effort  
18 to mitigate.

19 With regard to the rental of the Premises to a Halloween  
20 store, Flagship asserts that Excel is repeating an argument made  
21 unsuccessfully to the jury, that the temporary rental of the  
22 Premises during the litigation and just prior to trial barred  
23 Plaintiffs' constructive eviction claim. Flagship asserts that  
24 Excel's reference to the Rule 50 motion transcript fails to  
25 report that the Court denied Excel's Rule 50 motion on the  
26 constructive eviction claim. (Flagship's Supp. Excerpts of  
Record, Exh. 0, 1415-1450). Flagship asserts that Excel did not  
argue to the jury that the Halloween store payment was a ground  
to deny rescission; the jury found for Flagship on the  
constructive eviction claim and that Flagship had mitigated its  
damages.

Flagship's entry into the Forebearance Agreements with The  
Money Store and its continued payment of rent did not constitute  
a waiver of any right to rescind the lease. Flagship continued

1 to make the rental payments under protest. Excel's trial counsel  
2 affirmatively represented to the Court during trial that  
3 Flagship's continued payment of rent did not impair Flagship's  
4 ability to rescind the lease, nor was it used to argue waiver.  
5 The Court made an evidentiary ruling and limited evidence and  
6 argument to the jury based on Excel's representation. To now  
7 allow Excel to argue that Flagship's continued payment of rent  
8 waived any right of rescission would be rewarding bad faith and  
9 is wholly inconsistent with Excel's earlier position, upon which  
10 the Court relied in making rulings and Flagship relied in  
11 limiting its proof. It would give Excel an unfair advantage  
12 which prejudices Flagship at this late stage of the proceedings.  
13 The elements of judicial estoppel are met and Excel is estopped  
14 to claim waiver based on the Money Store loan and Flagship's rent  
15 payments.

16 As to Flagship's attempts to market the premises for  
17 sublease and its sublease in October 2003 do not establish  
18 Flagship's waiver of rescission. Excel never argued to the jury  
19 or during the lengthy post-trial proceedings that these actions  
20 by Flagship waived any right of rescission. Excel's conduct is  
21 unacceptable. Flagship's actions to reduce its losses were under  
22 protest and do not constitute a waiver of the right of  
23 rescission.

24 c. Rescission Barred Because Flagship Failed to  
25 Proffer Written Consent of The Money Store to Extinguish the  
26 Estate Created by the Ground Lease as Required by Section 22.4.

1 For what appears to be the first time, Excel now argues that  
2 rescission is barred because Flagship failed to proffer the  
3 written consent of The Money Store to extinguish the estate  
4 created by the Lease as required by Section 22.4 of the Lease.

5 Section 22.4, captioned "No Merger of Title," provides:

6 There shall be no merger of this Lease or the  
7 estate created by this Lease with any other  
8 estate in the Premises or any portion thereof  
9 by reason of the fact that the same person,  
10 firm, corporation or other entity may acquire  
11 or own or hold, directly or indirectly:

12 (a) this Lease or the estate  
13 created by this Lease or any interest in this  
14 Lease or in any such estate and

15 (b) any other estate in the  
16 Premises or any part thereof or any interest  
17 in such estate, and no such merger shall  
18 occur unless and until all persons,  
19 corporations, firms and other entities,  
20 having any interest (including a security  
21 interest) in (i) this Lease or the Estate  
22 created by this Lease and (ii) any other  
23 estate in the Premises or the improvements or  
24 any portion thereof shall join in a written  
25 instrument effecting such merger and shall  
26 duly record the same.

18 Excel contends that an order granting rescission would  
19 effectively extinguish the leasehold estate created by the Ground  
20 Lease and thereby merge Flagship's former leasehold estate into  
21 Excel's fee estate. This merger, Excel argues, is prohibited by  
22 Section 22.4 in the absence of The Money Store's written consent,  
23 which Flagship did not proffer. Excel cites *Swanston v. Clark*,  
24 153 Cal. 300, 304 (1908) as authority.

25 *Swanston*, a more than 100 year old case, first surfacing  
26 eight years after this action commenced, involved an action to

1 enforce specific performance of a written contract to sell real  
2 estate. The complaint alleged that the contract consisted of a  
3 lease for five years and an option to the lessees to purchase the  
4 property at any time during the term of the lease for a fixed  
5 price per acre; that plaintiffs, the lessees, elected to buy the  
6 land pursuant to the option, made due tender of the purchase  
7 price and demanded execution of the deed, which defendant  
8 refused; that two clauses to which the parties had agreed, to the  
9 effect that the plaintiffs were to allow improvements made by  
10 them during their possession to remain on the premises, in case  
11 they failed to exercise the option to purchase, and that  
12 plaintiffs should pay the rent for the five years, if they did  
13 not sooner exercise the option to purchase, were, by mutual  
14 mistake, omitted from the contract, and that by like mistake a  
15 clause was inserted giving plaintiffs the right to remove such  
16 improvements if they did not purchase. The defendant, in her  
17 answer, alleged that the contract had been rescinded by her  
18 before the plaintiffs' tender. The Supreme Court affirmed,  
19 sustaining a demurrer to this part of the answer:

20           It did not aver an offer to repay the  
21           plaintiffs the money expended by them in  
22           improvements on the land, but only to repay  
23           the moneys 'paid her by them' and 'to restore  
24           everything received by her under the  
25           agreement.' The complaint alleges the making  
26           of valuable improvements by the plaintiffs on  
             the faith of the option to purchase. This  
             special answer did not deny the making of  
             these improvements and it cannot be said that  
             the improvements had been 'received' by the  
             defendant. Hence, the offer to restore, as  
             alleged in the answer, did not include an

1 offer to compensate the plaintiffs for the  
2 moneys expended by them in improving the  
3 property and was insufficient to accomplish a  
4 rescission. Again, a party to a contract  
5 cannot rescind at his pleasure, but only for  
6 some one or more of the causes enumerated in  
7 section 1689 of the Civil Code. One seeking  
8 to rescind a contract, or to enforce a  
9 rescission when he claims he has effected in  
10 the manner provided in section 1691 of the  
11 Civil Code, must allege facts showing that he  
12 had good right to rescind, and for what cause  
13 a rescission had taken place, or that a  
14 rescission had been made by consent ... The  
15 same rule controls where a rescission is  
16 averred as a defense ... The special defense  
17 does not aver any facts in regard to  
18 defendant's right to rescind and does not  
19 show a rescission by consent. It is  
20 therefore insufficient.

21 The court did not err in adjudging that the  
22 defendant should convey the land free from  
23 all liens and encumbrances. The contract  
24 provided that she should convey it free from  
25 all liens and encumbrances, 'except such as  
26 may be created by the terms of this  
instrument as a lease of said premises." The  
conveyance of the property to the plaintiffs  
in fee would effect a complete merger of the  
two estates, and the lease would not  
thereafter be an encumbrance. The execution  
of the deed by the defendant would be a  
complete performance so far as the lease was  
concerned. The contract, as reformed, did  
not contemplate or provide that she should  
retain any right or interest under the lease  
after she had conveyed in pursuance of the  
option, even if it did not have that effect  
before reformation. The lease, therefore,  
did not constitute an encumbrance within the  
scope of the covenants in a grant deed. We  
cannot, upon these appeals, take notice of  
any liens for reclamation district taxes that  
may have accrued after the trial. The  
defendant, it may be observed, could have  
escaped that liability at any time by  
performing the liability accrued. The  
statement in the record relating to the  
motion made by defendant to amend the  
judgment so as to except such liens, and the

1 order denying the same, show that the  
2 judgment was entered before the motion and  
3 order were made. It was therefore an order  
4 made after final judgment and it cannot be  
5 reviewed on appeal from the judgment itself.  
6 The defendant did not appeal from the order.  
7 As to the liens for ordinary taxes, which may  
8 be presumed to have accrued between the time  
9 of plaintiffs' tender, in January, 1903, and  
10 the date of the entry of the judgment, in  
11 January, 1905, it is sufficient to say that  
12 the defendant, having refused to accept the  
13 money and make the deed as the judgment  
14 declares she should have done, is in no  
15 position to complain of the consequence of  
16 her own breach of contract.

17  
18 Flagship replies that Section 22.4 is not an anti-rescission  
19 clause:

20  
21 Rather, its purpose is simply to prevent the  
22 extinguishment of the Lease by operation of  
23 the doctrine of equitable conversion in the  
24 event the ground upon which the restaurant  
25 was acquired by Flagship, the lessee [sic].  
26 This clause simply has no application to  
Plaintiffs' claim of rescission. Nor does  
this provision make a third party's consent  
necessary for the Plaintiffs to elect any  
particular remedy. It simply prevents a  
merger of the leasehold estate with the fee  
estate, in order to protect secured lenders  
such as The Money Store. In fact, this  
provision is simply a confirmation of the  
equitable nature of the doctrine of merger,  
and the principle 'that the doctrine [will]  
not be applied to extinguish a leasehold  
estate when the lessee acquire[s] the fee,  
when the application of the doctrine would  
[prejudice the rights of an innocent third  
party.'

27  
28 In so asserting, Flagship cites *6424 Corporation v.*  
29 *Commercial Exchange Property, Ltd.*, 171 Cal.App.3d 1221 (1985).

30  
31 *6424 Corporation* involved real property subject to a 99-year  
32 ground lease which began in 1912. Holland Park Investors

(Holland) became the owner of the leasehold interest on December 17, 1980. The leasehold at that time was subject to purchase money encumbrances consisting of a \$400,000 first trust deed in favor of Commercial Exchange (CEL), an \$840,000 all-inclusive second trust deed in favor of La Mesa Enterprises (La Mesa), and a \$2.2 million all-inclusive third trust deed in favor of Commercial Exchange Property (CEP). Holland immediately sold its leasehold interest to the Kures. Two days later, the Kures purchased the fee interest in the property, thereby becoming concurrent owners of the fee and the leasehold. Two years later, the Kures conveyed their interests in the property by grant deed to IFR Realty, which the next day conveyed the property to Wendt. In that transaction, Wendt executed and delivered a trust deed in favor of IFR which encumbered the fee. A year later, IFR assigned Wendt's trust deed to 6424 Corporation. Thereafter, 6424 Corporation brought an action for declaratory relief and cancellation of instruments, asserting that the leasehold was merged with the fee when the Kures acquired concurrent ownership of both estates, with the result that the liens associated with the trust deeds of CEL, La Mesa and CEP were extinguished. The trial court granted summary judgment for CEL, La Mesa and CEP, declaring that the leasehold and the fee did not merge so as to render their trust deeds invalid. The Court of Appeals affirmed:

While various arguments for reversal and in support of the trial court's determination are proffered by the parties, we are of the view the matter is disposed of by a principle sufficiently fundamental as to require little

1 discussion, namely that: 'The doctrine of  
2 merger is to be applied in a manner  
3 calculated to prevent injustice, injury and  
4 prejudice to the rights of innocent third  
5 persons [such that] it has been held that the  
6 doctrine [will] not be applied to extinguish  
7 a leasehold estate when the lessee acquire[s]  
8 the fee, when the application of the doctrine  
9 would [prejudice] the rights of an innocent  
10 third party.' ....

11 In contravention of this well-founded and  
12 manifestly equitable proposition, what is  
13 sought to be established by appellant is no  
14 more nor less than that, based solely upon  
15 the circumstance of the fee and the leasehold  
16 estates having been placed in the ownership  
17 of the Kures, the otherwise legitimate  
18 interests of respondents, acknowledged and  
19 accepted as valid by the Kures ..., should be  
20 found to have disappeared, through  
21 application of a rule which in all events  
22 'arose out of the fondness of the law for  
23 convenience and symmetry, [but which] was  
24 never designed to defeat the rights of a  
25 third party, which had intervened before the  
26 merger took effect.' ....

171 Cal.App.3d at 1223-1224.

Excel argues that *6424 Corporation* is distinguishable:

17 There, the lease did not contain an anti-  
18 merger clause, whereas here, § 22.4  
19 specifically requires the signature of all  
20 interested parties as a precondition to  
21 extinguish the lease. Furthermore, it was  
22 the *tenant* in *6424 Corp.* that had acquired  
23 the fee estate and, thereafter, wrongfully  
24 attempted to escape its liabilities by  
25 extinguishing the interests of the leasehold  
26 mortgagees via merger. In contrast, here,  
the effect of the tenant rescinding would be  
to merge the lease estate into the *landlord's*  
fee estate. The litigation issues in *6424*  
*Corp.* were the result of the absence in that  
lease of a provision such as § 22.4. *6424*  
*Corp.* is actually a case study to remind  
practitioners to include clauses such as §  
22.4, particularly in long-term ground  
leases.

1       Flagship argues that The Money Store consented to the  
2 prosecution of the action, including the claim for rescission  
3 when it entered into the Forebearance Agreements with Flagship.

4       Flagship refers to Paragraphs 6-7 of the October 2001  
5 Forebearance Agreement :

6             D. The parties have reached an agreement to  
7       forebear on the existing collection actions  
8       and lawsuit. In consideration of the mutual  
9       promises, covenants, conditions and terms set  
10       forth herein, and in consideration of the  
11       accuracy of the Recitals, which are hereby  
12       confirmed and incorporated into this  
13       agreement by this reference, the undersigned  
14       parties hereby agree as follows:

15             ...

16             6. TMSIC hereby agrees to release  
17       its interest in the Modesto Property at 1800  
18       Prescott Road in Modesto, California for the  
19       sum of \$900,000 provided that sum is the  
20       proceeds from the result of the sale to Mr.  
21       Valdez and Mr. Vaca or such other tenant as  
22       the landlord may approve provided that the  
23       minimum release payment from such other  
24       tenant as the landlord may approve will be  
25       \$900,000 or the net proceeds available from  
26       the sale, whichever is greater. It is  
understood that this payment amount shall be  
applied to past due arrearages on the Modesto  
loan and then to the principal on the Modesto  
loan. At no time should the payment under  
this paragraph exceed the balance due under  
the loan.

7. Flagship and Reiche agree to  
execute an appropriate assignment to Money  
Store and TMSIC the [sic] net proceeds of the  
litigation of Reiche and Flagship in Case No.  
290308, in Stanislaus County [removed on  
February 21, 2001 and assigned Case No. CV-F-  
02-5200]. The proceeds will be applied to  
the past-due arrearages on the Modesto Loan,  
if any, and then to a reduction of the  
principal balance. Flagship will be  
reimbursed for all costs, attorney fees and

1 expert witness fees and other expenses  
2 incurred in the litigation, including  
3 Flagship's payment of rent to the landlord  
4 since the closure of Flagship's restaurant on  
5 April 1, 2001. The reimbursement will first  
6 come from the proceeds of the litigation.  
7 The first \$500,000.00 of the net proceeds  
8 would go to TMSIC. Any net proceeds over  
9 \$500,000.00 from the litigation will be  
10 equally divided between TMSIC and Flagship.  
11 TMSIC will share in the net proceeds only to  
12 the extent required to satisfy past-due  
13 arrearages on the Modesto Loan and pay the  
14 principal balance on the Modesto Loan in  
15 full.

16 (Excel's Response, Exh. B). Flagship asserts that the interests  
17 of The Money Store were fully protected in the Forebearance  
18 Agreement "and no intent is evinced by that agreement that The  
19 Money Store, originally a party to the lawsuit and well aware of  
20 Flagship's claims for rescission, had any objection to the remedy  
21 of rescission."

22 Excel replies that Flagship's reliance on Paragraphs 6-7 of  
23 the October 2001 Forebearance Agreement is misplaced. Referring  
24 to Paragraph 6, Excel contends: "Obviously, Plaintiffs never  
25 adduced evidence of a sale to Mr. Valdez and Mr. Vaca or anyone  
26 else, because such event did not occur." Excel contends:

Nothing in the Forebearance Agreement  
provides the written consent required by §  
22.4. On the contrary, the Forebearance  
Agreement requires Plaintiffs to pay rent and  
otherwise maintain the Ground Lease in good  
standing to protect TMS's security interest.  
(*Id.* at ¶¶ 4,7).

Excel asserts that the October 2002 Forebearance Agreement  
deleted paragraph 6 and was silent with respect to The Money  
Store's security interest.

1       Excel's view of the terms of the October 2002 Forebearance  
2 Agreement are misplaced. While the references to the proceeds of  
3 the sale to Valdez and Vaca were deleted, it does not appear that  
4 the October 2002 Forebearance Agreement "was silent with respect  
5 to The Money Store's security interest." Section F of the  
6 October 2002 Forebearance Agreement provides:

7           The parties have reached an agreement to  
8           forebear on the existing collection actions.  
9           In consideration of the mutual promises,  
10          covenants, conditions and terms set forth  
11          herein, and in consideration of the accuracy  
12          of the Recitals, which are hereby confirmed  
13          and incorporated into this agreement by this  
14          reference, the undersigned parties hereby  
15          agree as follows:

16           1. Money Store and TMSIC shall  
17           forebear from filing their Notice of Sale on  
18           the Stockton Loan and the Modesto Loan.

19           ...

20           4. Flagship and Reiche shall  
21           continue to make monthly lease payments on  
22           the Modesto Property to Excel Realty Partners  
23           ....

24           5. Net proceeds of any litigation  
25           between Reiche and Flagship in the United  
26           States District Court, Eastern District case  
27           ... will be applied to past due arrearages on  
28           the Modesto Loan, if any, and then to a  
29           reduction of the principal balance. Flagship  
30           will be reimbursed for all costs, attorney  
31           fees and expert witness fees and other  
32           expenses incurred in the litigation,  
33           including Flagship's payment of rent to the  
34           Landlord since the closure of Flagship's  
35           restaurant on April 1, 2001. The  
36           reimbursement will first come from proceeds  
37           of the litigation. The first \$500,000.00 of  
38           the net proceeds will go to TMSIC. Any net  
39           proceeds over \$500,000.00 from the litigation  
40           will be equally divided between TMSIC and  
41           Flagship. TMSIC will share in the net

1 proceeds only to the extent required to  
2 satisfy past due arrearages on the Modesto  
3 Loan and pay the principal balance on the  
4 Modesto Loan in full.

5 6. The forbearance of publishing  
6 the Notice of Sale shall continue until the  
7 earlier of the failure of Reiche and Flagship  
8 to honor each and every term and condition  
9 obtained herein, the issuance of a final  
10 judgment in Case No. CIV-F-02-5200 REC DLB,  
11 in the United States District Court, Eastern  
12 District, or twelve (12) months from the date  
13 of execution of this Agreement.

14 (Excel Response, Exh. C.).

15 Flagship further asserts: "[A]s noted on the record, The  
16 Money Store received payment, and accordingly no longer has any  
17 interest in the property." In so asserting, Flagship refers to  
18 the transcript of a status conference on February 15, 2006:

19 THE COURT: All right. And as I then would  
20 understand it, all of this activity that is  
21 the subject of concern happened after the  
22 trial and after Mr. Reiche's accident.

23 MR. FAIRBROOK: Yes ... A year and a half  
24 after the trial, we did enter into  
25 negotiations and we retired that obligation.  
26 And, as a result, the only significance to  
this case is that the Court had indicated in  
its prior ruling that we would receive as  
compensation interest on that loan, not - the  
principal was never alleged to have been an  
item of damage, but simply the financing  
charges. [¶] And in the submission that we  
submitted to your Honor, we stopped the  
accrual of that interest at the same time as  
that loan was retired, and that's the only  
significance that I can see on this.

(Flagship's Supp. ER, Exh. Q, 4:23-5:13). Flagship also submits  
Exhibit S in its Supplemental Excerpts of Record, a Substitution  
of Trustee and Reconveyance of Deed of Trust dated September 20,

1 2005, wherein The Money Store reconveyed any interest is the  
2 lease as part of the deed of trust to Flagship.

3 Excel moves to strike Exhibit S to Flagship's request for  
4 judicial notice filed in support of its reply brief and pages  
5 15:20-16:19 of Flagship's reply brief. Alternatively, Excel  
6 moves for leave to file a sur-reply brief.

7 In moving to strike, Excel relies on the Supplemental  
8 Scheduling Conference Order filed on August 14, 2009 (Doc. 499),  
9 states: "Plaintiff shall not raise any new matter in the reply  
10 memorandum of law."

11 It is Excel, not Flagship, that raised this issue in its  
12 opposition brief. The Supplemental Scheduling Order was not  
13 intended to preclude Flagship from responding to arguments made  
14 by Excel in its opposition to Flagship's motion.

15 Excel also bases its motion to strike on the ground that  
16 Flagship's exhibit and argument violate that "Memorandum Decision  
17 Re Rescission Damages and Availability of Prejudgment Interest"  
18 filed on November 14, 2006, (November 14, 2006 Memorandum  
19 Decision; Doc. 387), which Excel asserts barred evidence of  
20 Flagship's post-trial dealings with The Money Store. The portion  
21 of the November 14, 2006 Memorandum Decision discussing accrued  
22 interest on The Money Store Loan through trial, provides:

23 Most critically, what Wallace did not do was  
24 to calculate (or otherwise consider) the  
25 effect of the foreclosure agreement on the  
26 calculation of interest accruing after  
October 2001. Nor did he give credit for the  
\$900,000 lump sum payment or calculate  
interest based on the reduced unpaid

1 principal balance resulting from the lump sum  
2 payment. It was incumbent on Plaintiffs to  
3 make these calculations. They have not done  
4 so. They have failed to prove the amount of  
5 any accrued unpaid interest on the Money  
6 Store Loan and the effect of the forbearance  
7 agreement on the accrual of interest.  
8 *Plaintiffs did not present this information*  
9 *at trial and refused to provide such evidence*  
10 *post trial. They are bound by their choice.*  
11 *Plaintiffs shall not recover any other*  
12 *accrued interest.*

13 (Doc. 387; 20:9-21, emphasis added]. Excel argues that Flagship  
14 is bound by this ruling and by their choice that evidence of  
15 Flagship's post-trial dealings with The Money Store will not be  
16 admitted. Excel contends that Flagship now attempts a "back door  
17 maneuver" to put into the record evidence that the November 14,  
18 2006 Memorandum Decision bars, Exhibit S. Excel contends that  
19 the stated purpose for proffering Exhibit S is to show that The  
20 Money Store received payment and, accordingly no longer has any  
21 interest in the property:

22 Plaintiffs had the burden to prove at trial  
23 that they were entitled to rescind the Ground  
24 Lease, but they failed to meet it. It was  
25 not Excel's burden to prove that rescission  
26 was unavailable. Plaintiffs failed to adduce  
evidence of TMS's consent to a merger of the  
Ground Lease estate with the fee, which would  
be the direct result of the rescission  
Plaintiffs sought. Evidence of TMS's consent  
was essential for Plaintiffs to comply with §  
22.4, and Plaintiffs are foreclosed from  
proffering it now.

27 As the ruling provides, Flagship was precluded from offering  
28 evidence about postjudgment interest. To the extent that Excel  
29 moves for leave to file a sur-reply brief addressing the impact  
30 of Exhibit S, the motion is moot. Excel's arguments in

1 opposition to Flagship's discussion of Exhibit S have been fully  
2 considered.

3 Flagship was not required to obtain Excel's written consent  
4 to the Money Store loan. There is no merger. Excel's arguments  
5 fail.

6 CONCLUSION

7 For all the reasons stated, the lease, in its entirety,  
8 allows for rescission and California law would give effect to  
9 rescission of the lease under the totality circumstances of this  
10 action.

11 IT IS SO ORDERED.

12 Dated: December 20, 2010

/s/ Oliver W. Wanger  
UNITED STATES DISTRICT JUDGE